

INTERNATIONAL MONETARY FUND QUOTA INCREASE

HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS UNITED STATES SENATE NINETY-EIGHTH CONGRESS FIRST SESSION SPECIAL HEARING

Printed for the use of the Committee on Appropriations



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1983

20-884 O

5181-6

COMMITTEE ON APPROPRIATIONS

SUBCOMMITTEE ON FOREIGN ASSISTANCE AND RELATED PROGRAMS

ROBERT W. KASTEN, Jr., Wisconsin, *Chairman*

MARK O. HATFIELD, Oregon

ALFONSE M. D'AMATO, New York

WARREN RUDMAN, New Hampshire

ARLEN SPECTER, Pennsylvania

DANIEL K. INOUE, Hawaii

J. BENNETT JOHNSTON, Louisiana

PATRICK J. LEAHY, Vermont

DENNIS DeCONCINI, Arizona

JOHN C. STENNIS, Mississippi

(Ex officio)

SUBCOMMITTEE STAFF

JAMES D. BOND

JANE S. MCGHEE

RICHARD L. COLLINS, *Minority*

CONTENTS

TUESDAY, MAY 17, 1983

DEPARTMENT OF THE TREASURY

	Page
Secretary of the Treasury: Statement of Hon. Donald T. Regan	1
Prepared statement.....	9
Charts A-1	28-36
IMF press releases	37, 54
Questions submitted by Senator Kasten.....	85
Questions submitted by Senator Hatfield	94
Questions submitted by Senator Inouye.....	98
Grand Strategy, publication of November 1, 1982.....	112
Grand Strategy, publication of February 15, 1982	124
Wall Street Journal, publication of May 7, 1982.....	136

WEDNESDAY, MAY 18, 1983

NONDEPARTMENTAL WITNESSES

Paul Craig Roberts, professor of political economy, Center for Strategic and International Studies, Georgetown University.....	139
Prepared statement.....	143
Jack Pierce, treasurer, the Boeing Co., on behalf of U.S. Chamber of Commerce	158
Prepared statement.....	160
Philip G. Moon, senior vice president, National Bank of Detroit, on behalf of the Bankers' Association for Foreign Trade.....	167
Prepared statement.....	175
George J. Clark, executive vice president, Citibank.....	199
Prepared statement.....	201

INTERNATIONAL MONETARY FUND QUOTA INCREASE

TUESDAY, MAY 17, 1983

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 11 a.m., in room SD-192, Dirksen Senate Office Building, Hon. Robert W. Kasten, Jr. (chairman) presiding.

Present: Senators Kasten, Rudman, Specter, Stennis, and Inouye.
Also present: Senator Humphrey.

DEPARTMENT OF THE TREASURY

SECRETARY OF THE TREASURY

STATEMENT OF HON. DONALD T. REGAN, SECRETARY OF THE TREASURY

OPENING STATEMENT OF SENATOR KASTEN

Senator KASTEN. The subcommittee will come to order.

This morning we begin hearings on the International Monetary Fund quota increase request. Our witness this morning is the Honorable Donald T. Regan, Secretary of the Treasury. Tomorrow we will hear from outside witnesses.

This particular request has generated a great deal of controversy and has made an already full foreign policy assistance request for Congress to consider this year even fuller.

ISSUE OF IMF QUOTA INCREASE

The issue of the IMF quota increase has concerned constituents over what they see as Federal tax dollars bailing out private banks who made loans overseas at fantastic rates on the basis of continued high inflation, oil prices reaching \$90 a barrel, by some estimates, and continued high growth rates.

Many of the critics of the IMF believe these banks will be getting a direct benefit through the IMF because the quota increase will provide countries with the necessary resources to enable them to continue servicing debts which otherwise might be bad.

On the other hand, those in favor of the IMF quota increase continue to express various degrees of concern with respect to the international financial system as a whole, as well as the financial

condition of various countries, some of which are very important to U.S. interests, both politically and economically.

I think it is important to note the Senate Banking Committee has reported out the authorization legislation with no dissenting votes, a feat which I guess would lead us to congratulate you, Mr. Secretary, on the work that you and other members of the administration have done, as I think many of us expected the legislation to have a much tougher time in the Banking Committee.

Despite that result I need not tell you many Members of the Senate remain concerned over the legislation, and hopefully the hearings we will be having in the next couple of days will give us on the Appropriations Committee enough information to enable us to conclude our deliberations on this matter when the committee marks up the supplemental appropriations legislation.

Mr. Secretary, as you know, your full statement will be included in the record. In the interest of time you might want to summarize your remarks so that there will be more time for questions.

Senator Inouye, do you have an opening statement?

Senator INOUE. I would like to join you in welcoming the Secretary.

Senator KASTEN. Mr. Secretary, thank you for joining us. Please proceed.

Mr. REGAN. Thank you, Mr. Chairman.

It is a pleasure to appear before you today to explain and support the administration's proposals for legislation to increase the resources of the International Monetary Fund.

I have just returned from a series of international meetings, one in Mexico for discussion of Mexican-American economic issues, in Manila for the annual Asian Development Bank meeting and for a joint Philippine-American Economic Issue Conference, and in Paris for the OECD ministerial and for a gathering of finance and trade ministers that Bill Brock and I arranged to deal with the debt situation.

WORLD DEBT CRISIS

I have heard it said by some that the debt crisis is over, that the increase in IMF resources is not needed. I can assure you that this is not the view of the rest of the world, either the developing countries struggling to work out their debt problems or the creditor governments that have the principal responsibility for assuring an open, stable international financial and economic system, nor is it mine. The crisis is not over.

The increase in IMF resources is a central element of an agreed international strategy to deal with the crisis. It is critically important that the United States, the administration, and the Congress exercise its leadership in carrying through that strategy.

The written testimony that I have submitted develops our proposals and their rationale in detail. In my remarks today I will focus on the central role that the IMF must play in our strategy for dealing with the international debt problem.

The international debt problems of a number of borrowers combined with a sharp cutback in bank lending are such that the in-

ternational economic and financial systems are undergoing a major strain that threatens to derail the world economic recovery.

Chart A illustrates the rapid buildup of total debt by non-OPEC developing countries in recent years and the expansion of commercial bank lending to less developed nations. You can see total debt versus debt to the commercial banks.

Chart B illustrates the sharp cutback in new commercial lending to LDC's last year. There is a dip in 1977 followed by a rise in commercial bank lending, and another sharp dip in 1982.

The problem is one of speed and degree of adjustment. Borrowing countries must adjust their economies to slow their borrowing and maintain the capacity to service their debt, but there is a limit to the speed with which major adjustments can be made. Effective and orderly adjustment takes time and attempts to push it too rapidly can be destabilizing.

U.S. INTEREST IN INTERNATIONAL DEBT PROBLEM

There are several reasons why the United States should be concerned with the international debt problem. A cutoff of financing forces dramatic cuts in economic activities and imports by borrowing countries.

A further abrupt and large-scale contraction of LDC imports could do major damage to the U.S. economy because about one-third of any cutback in imports by LDC's comes directly out of American exports and American export-related jobs. Foreign trade has become increasingly important to the U.S. economy.

U.S. EXPORTS

This chart, Mr. Chairman, illustrates the very rapid expansion of U.S. exports during the 1970's. Trade was the fastest growing part of the world economy in the last decade and in the latter part of the decade U.S. export volume grew more than twice as fast as total world exports.

You can see on this chart U.S. export volume in red and total world export volume in blue. You can see how much better the United States has done in its exports over the last few years than the rest of the world.

As a result of this growth as shown here on the next chart, U.S. exports in 1980 accounted for 19 percent of the total U.S. production of goods compared to only 9 percent 10 years earlier. In 1970, total goods produced by the U.S. were valued at \$460 billion, of which exports amounted for 9 percent. In 1980 we had a total output of \$1,142 billion, of which exports account for 19 percent.

The U.S. agricultural exports rose from \$7 billion in 1970 to \$42 billion in 1980. Our surplus in agricultural trade rose from \$1.6 billion to \$24.3 billion. In 1970 total agricultural exports accounted for 17 percent of our \$43 billion in total exports. In 1980, agriculture accounted for 19 percent of our \$221 billion in exports. We had a surplus of \$24 billion in agricultural trade in that year.

Our trade balance in services which is illustrated on the next chart, rose from \$3 billion in 1970 to \$34 billion in 1980 and \$36 billion in 1982.

By 1980 U.S. export-related jobs totaled some 5.1 million as shown on this chart. This represents an increase of over 75 percent in export-related jobs during the 1970's. As of 1980, each \$1 billion of U.S. exports was estimated to result in 24,000 jobs.

In 1970, 3.7 percent of total civilian employment was in export-related jobs. Now, an estimated 5.1 percent of total civilian employment is export-related jobs.

In 1980, nearly 30 percent of U.S. exports went to non-OPEC LDC's representing a market for U.S. goods of nearly \$63 billion. In 1970 25 percent of total exports, about \$11 billion, went to the non-OPEC countries. Bear in mind that these important trading partners are the very countries with IMF programs.

IMPACT OF BANKING LOSSES

On the banking side there are also impacts of concern to all Americans. If the situation is not managed carefully, widespread banking losses could result. This could lead to a major reduction in the banks' ability to lend to domestic customers and significant upward pressure on U.S. interest rates. Our strategy for dealing with this threat has five elements.

First, and in the long run most important, there must be effective adjustment in the borrowing country.

The second element is the continued availability of temporary balance of payments financing from the IMF.

Third is bridge financing by governments and central banks in lending countries in exceptional cases of systemic danger.

Fourth is continued commercial bank lending to countries that are pursuing sound adjustment policies.

The final part of our strategy is to restore sustainable economic growth while avoiding protectionism which threatens both our long-run growth prospects and the balance of payment adjustment efforts of the borrowing countries.

IMF CONDITIONALITY

The main reason the IMF has such a central role in our strategy is the conditionality attached to its lending. The financing enables borrowers to adjust in an orderly manner. Conditionality is designed to make sure the necessary adjustments actually take place. This also acts as a catalyst for additional private and official financing.

It now appears virtually certain that the IMF's ability to commit resources to future adjustment programs will be exhausted by the end of this year. If the IMF is to continue playing a central role in resolving the debt problem, its resources will have to be expanded by then.

AMOUNT OF QUOTA INCREASE

At the beginning of the current discussion of IMF resources in 1981 many IMF members favored a doubling or even tripling of the quotas. Ultimately, however, the IMF membership agreed to our proposal.

First, a much smaller quota increase of 47 percent which, in current dollar terms, is an increase from \$66 billion to \$98 billion.

Second, the establishment of a contingency borrowing arrangement that would be available to the IMF on a standby basis to use in situations threatening the stability of the system as a whole. The IMF General Arrangements To Borrow (GAB) would be modified for this purpose and increased in dollar terms from \$7 to about \$18 billion.

Overall, the proposed increase in the U.S. commitment to the IMF totals the equivalent of \$8.4 billion at current exchange rates. Of that total, about \$5.8 billion would be for the quota increase and \$2.6 billion for the General Arrangements To Borrow.

Now, Mr. Chairman, a number of issues have been raised in connection with the proposed increase in IMF resources. I have discussed these in detail in my written statement, but will simply mention a few of the main ones now.

BUDGETARY AND FINANCIAL IMPACT

Because we receive a liquid monetary reserve asset in connection with our actual transfer of cash to the IMF, these transfers do not result in net budget outlays or an increase in the budget deficit.

They do affect Treasury borrowing, but this impact occurs over time as our quota in the IMF is drawn upon for lending. The \$5.8 billion we are proposing to add to our IMF quota would not raise Treasury borrowing by that full amount next year. Our guess is that at the most a quota increase would lead to annual increases in Treasury borrowing in the \$1 billion to \$1½ billion range during the period 1984 to 1987.

The \$2.6 billion increase in U.S. commitments to the GAB is for contingencies involving a serious threat to the system. Our hope is that it will not need to be drawn on at all.

DOES THE IMF PROMOTE PROTECTIONISM AND HURT U.S. EXPORT

Contrary to a popular view that IMF programs force import and growth reductions and encourage protectionism, a primary objective of IMF programs is to reduce trade barriers and facilitate expansion of world trade. In fact, a country's imports and its economic growth under an IMF program are very often higher than during the period before the program went into effect, and are far higher than they would be without the program. In many cases lack of an IMF program would force abrupt and disorderly adjustment, with a collapse of imports and economic activity. We saw this happen in Mexico, which is our third largest trading partner and with which we had a substantial trade surplus in 1981. Our \$4 billion trade surplus with Mexico in 1981 was transformed into a \$4 billion trade deficit in 1982 as Mexico experienced severe debt and liquidity problems. This was an \$8 billion deterioration. It was the worst swing in trade performance with any country in the world and was due almost entirely to Mexico's financing problems.

This situation is now turning around due in large part to the fact that in late December an IMF program for Mexico went into effect.

IS THE IMF A BANK BAILOUT

There is a widespread concern that increased IMF resources would be used to bail out banks. A bailout would occur if someone else's money were to replace that of the banks in lending to various countries. In fact, the steps now being taken to deal with the debt problem require continued bank involvement.

Orderly adjustment actually requires that banks increase lending to troubled borrowers that adopt serious economic programs in conjunction with effective IMF adjustment programs. If this is done prudently it will over time permit modest reductions in bank exposure in relation to capital.

At the same time the banking regulatory authorities—Federal Reserve, Controller of the Currency and the FDIC—have been working with the Banking Committees of both the Senate and House to improve the regulatory environment in banking practices.

Regulators have submitted a comprehensive set of regulations calling for greater scrutiny of foreign lending, special reserves for loans to countries facing protracted payment difficulties and amortization of front-end fees used to increase yields.

The Banking Committees of both Houses have reported bills dealing with these areas. The bills differ in some important respects, but I am hopeful that a suitable bill will be approved which both strengthens lending practices and permits prudent levels of continued bank lending while the process of adjustment in borrowing countries is underway.

AREN'T THERE ANY ALTERNATIVES

There have been various proposals for basic alternatives to the IMF quota increase, and indeed to the general strategy that has been adopted to deal with the debt problem. These generally involve sales or use of the IMF gold as a substitute for the quota increase, or some kind of generalized system of debt relief or large-scale writeoff of debt.

I do not believe these proposals are either realistic or desirable. Very briefly, the gold sale proposal would erode the security of our own and other creditors' claims on the IMF and would probably cause a sharp drop in gold prices. The sale of much of the IMF gold reserve would also put pressure on interest rates in our capital market similar to or greater than the effect of Treasury borrowing necessitated by the quota increase. Moreover, gold sales would weaken rather than strengthen the institution at the heart of our strategy. Finally, such proposals would not and should not be accepted by the needed 85 percent majority of IMF members.

Proposals for generalized debt rescheduling fail to recognize the very substantial restructuring of debt that is already taking place or to distinguish among the different situations of borrowing countries.

Of the 20 largest LDC borrowers, accounting for 85 percent of total debt to banks, some 8 countries accounting for nearly 60 percent of the total have major restructuring in place or in progress. They differ in many ways. Generalized systems of debt relief are not needed nor appropriate.

Economic adjustment in borrowing countries is essential to resolving the debt problem and avoiding recurrence. These proposals would relieve many borrowers of essential pressure to adjust. Under some variants they could create major disincentives for lenders to provide needed credit in the future. Under others there would be high costs for governments and taxpayers.

Rescheduling and restructuring are taking place under the current strategy, but in a selective manner tailored to individual circumstances so as to minimize disincentives to needed adjustments and private financing and to avoid undue cost to the taxpayer.

The assumption underlying proposals for large-scale writeoffs of debt is that there is no hope of restoring orderly debt servicing and creditworthiness in many or most LDC borrowers. I do not agree with the basic assumption.

The major borrowers—many admittedly overextended today, with their export markets impaired by recession—resemble in important ways the developing U.S. economy of the 1800's. They require large amounts of capital to develop and grow.

With proper policies and a reasonably stable world environment, their economies, their capacity to earn foreign exchange and their ability to service debt will all expand. Most or all should, with effort and discipline, again become creditworthy.

Mandatory large-scale writeoffs would almost certainly cut off any future flow of new funds to LDCs and could induce banks to try to reduce their current exposure—making it virtually impossible for borrowers to adjust in an orderly and constructive way and putting enormous pressure on governments to pick up the financing burden.

And major writeoffs, by forcing the banks to take heavy losses which would wipe out their capital resources in the process, would cause the banking system to curtail domestic lending as well, tightening credit markets, raising interest rates and threatening our recovery.

CONCLUSION

In conclusion, if the gravity of the debt situation seems to have eased somewhat recently, that is in large part because the strategy to address it is in place and is beginning to show results. It is not over. Other countries might get into difficulties and require new IMF programs be instituted.

The process will take time and determination and it depends crucially on implementation of the increase in IMF resources because implementation of an effective IMF adjustment program by troubled borrowers is at the heart of our strategy. Prompt U.S. approval of the increase in IMF resources is important not only because the financing is needed, but also because it would be a sign of confidence to other governments and to the public and would help lay to rest concerns about the risks to global recovery.

But most important, timely approval of these proposals is essential to our own economic interests, to the problems for American businesses and American jobs. I urge that you give the legislation to put these proposals into effect your prompt and favorable consideration.

Thank you, Mr. Chairman.
[The statement of Mr. Regan follows:]

PREPARED STATEMENT OF HON. DONALD T. REGAN
SECRETARY OF THE TREASURY

The Increase in IMF Resources:
Protecting the Financial System,
Safeguarding U.S. Trade and Employment

Mr. Chairman and members of the Subcommittee:

It is a pleasure to appear before you today to explain and support the Administration's proposals for legislation to increase the resources of the International Monetary Fund. After extensive consultations and negotiations among IMF members, agreement was completed in February on complementary measures to increase IMF resources: an increase in quotas, the IMF's basic source of financing; and an expansion of the IMF's General Arrangements to Borrow (GAB), for lending to the IMF on a contingency basis, if needed to deal with threats to the international monetary system. These must now be confirmed by member governments, involving Congressional authorization and appropriation in our case, in order to become effective.

President Reagan submitted the Administration's legislative proposals to the Congress early in March. As background to those proposals, I would like to outline the problems facing the international financial system, the importance to the United States of an orderly resolution of those problems, and the key role the IMF must play in solving them.

The International Financial Problem

Around the middle of last year, the serious financial problems confronting the international monetary system became front-page news -- and correctly so, since management of these problems is critical to our economic interests. The debts of many key countries (including Argentina, Brazil, Mexico, and a growing list of others) became too large for them to continue to manage under present policies and world economic circumstances. In response, lenders began to retrench sharply, and the borrowers have since been finding it difficult if not impossible to scrape together the money to meet upcoming debt payments and to pay for essential imports. As a result, the international financial and economic system is experiencing strains that are without precedent in the postwar era and which threaten to derail world economic recovery.

There is a natural tendency under such circumstances for financial contraction and protectionism -- reactions that were the very seeds of the depression of the 1930s. It was in response to those tendencies that the International Monetary Fund was created in the aftermath of World War II, largely at the initiative of the United States, to provide a cooperative mechanism and a financial backstop to prevent a recurrence of that slide into depression. If the IMF is to be able to continue in that role, it must have adequate resources.

The current problem did not arise overnight, but rather stems from the economic environment and policies pursued over the last two decades. Inflationary pressures began mounting during the 1960's, and were aggravated by the commodity boom of the early 1970's and the two oil shocks that followed. For most industrialized countries, the oil shocks led to a surge of imported inflation, worsening the already growing inflationary pressures; to large transfers of real income and wealth to oil exporting countries; and to deterioration

of current account balances. For the oil-importing less developed countries -- the LDCs -- this same process was further compounded by their loss of export earnings when the commodity boom ended.

Rather than allowing their economies to adjust to the oil shocks, most governments tried to maintain real incomes through stimulative economic policies, and to protect jobs in uncompetitive industries through controls and subsidies. Inflationary policies did bring a short-run boost to real growth at times, but in the longer run they led to higher inflation, declining investment and productivity, and worsening prospects for real growth and employment.

Similarly, while these policies delayed economic adjustment somewhat, they could not put it off forever. In the meanwhile, the size of the adjustment needed was getting larger. Important regions remained dependent on industries whose competitive position was declining; inflation rates and budget deficits soared; and -- most pertinent to today's financial problems -- many oil importing countries experienced persistent, large current account deficits and unprecedented external borrowing requirements. Some oil-exporting countries also borrowed heavily abroad, in effect relying on increasing future oil revenues to finance ambitious development plans.

In the inflationary environment of the 1970's, it was fairly easy for most nations to borrow abroad, even in such large amounts, and their debts accumulated rapidly. Most of the increased foreign debt reflected borrowing from commercial banks in industrial countries. By mid-1982, the total foreign debt of non-OPEC developing countries was something over \$500 billion -- more than five times the level of 1973. Of that total, roughly \$270 billion was owed to commercial banks in the industrial countries, and more than half of that was owed by only three Latin American countries -- Argentina, Brazil, and Mexico. New net lending to non-OPEC LDCs by banks in the industrial countries grew at a rising pace -- about \$37 billion in 1979, \$43 billion in 1980, and \$47 billion in 1981 -- with most of the increase continuing to go to Latin America. (See Charts A and B.)

That there has been inadequate adjustment and excessive borrowing has become painfully clear in the current economic environment -- one of stagnating world trade, disinflation, declining commodity prices, and interest rates which are still high by historical standards. Over the past two years, there has been a strong shift to anti-inflationary policies in most industrial countries, and this shift has had a major impact on market attitudes. Market participants are beginning to recognize that our governments intend to keep inflation under control in the future and are adjusting their behavior accordingly.

In most important respects, the impact of this change has been positive. Falling inflation expectations have led to major declines in interest rates. There has been a significant drop in the cost of imported oil. On the financial side, there is a shift toward greater scrutiny of foreign lending which may be positive for the longer run, even though there are short-term strains. Lenders are re-evaluating loan portfolios established under quite different expectations about future inflation. Levels of debt that were once expected to decline in real terms because of continued inflation -- and therefore to remain easy for borrowers to manage out of growing export revenues -- are now seen to be high in real terms and not so manageable in a disinflationary world. As a result, banks have become more cautious in their lending -- not just to LDCs but to domestic borrowers as well.

There is certainly nothing wrong with greater exercise of prudence and caution on the part of commercial banks -- far from it. Since banks have to live with the consequences of their decisions, sound lending judgment is crucial. In addition, greater scrutiny by lenders puts pressure on borrowers to improve their capacity to repay, and creates an additional incentive for borrowing countries to undertake needed adjustment measures.

But a serious short-run problem has arisen as a result of the size of the debt of several key countries, the turn in the world economic environment, inadequacy of adjustment policies, and the speed with which countries' access to external financing has been cut back. Last year, net new bank lending to non-OPEC LDCs dropped by roughly half, to something in the range of \$20 to \$25 billion for the year as a whole (Chart B), and came to a virtual standstill for a time at mid-year. This forced LDCs to try to cut back their trade and current account deficits sharply to match the reduced amount of available external financing.

The only fast way for these countries to reduce their deficits significantly in the face of an abrupt cutback in financing is to cut imports drastically, either by sharply depressing their economies to reduce demand or by restricting imports directly. Both of these are damaging to the borrowing countries, politically and socially disruptive, and painful to industrial economies like the United States -- because almost all of the reduction in LDC imports must come at the direct expense of exports from industrial countries.

As the situation developed, there has been a danger that lenders might move so far in the direction of caution that they compound the severe adjustment and liquidity problems already faced by major borrowers, and even push other countries which are now in reasonably decent shape into serious financing problems as well.

The question is one of the speed and degree of adjustment. While the developing countries must adjust their economies to reduce the pace of external borrowing and maintain their capacity to service debt, there is a limit, in both economic and political terms, to the speed with which major adjustments can be made. Effective and orderly adjustment takes time, and attempts to push it too rapidly can be destabilizing.

Importance to the United States of an Orderly Resolution

It is right for American citizens to ask why they and their government need be concerned about the international debt problem. Why should we worry if some foreign borrowers get cut off from bank loans? And why should we worry if banks lose money? Nobody forced them to lend, and they should live with the consequences of their own decisions like any other business.

If all the U.S. government had in mind was throwing money at the borrowers and their lenders, it would be difficult to justify using U.S. funds on any efforts to resolve the debt crisis, especially at a time of domestic spending adjustment.

But of course, there is more to the problem, and to the solution. First, a further abrupt and large-scale contraction of LDC imports would do major damage to the U.S. economy. Second, if the situation were handled badly, the difficulties facing LDC borrowers might come to appear so hopeless that they would be tempted to take desperate steps to try to escape. The present situation is manageable. But a downward spiral of world trade and billions of dollars in simultaneous loan losses would pose a fundamental threat to the international economic system, and to the American economy as well.

In order to appreciate fully the potential impact on the U.S. economy of rapid cutbacks in LDC imports, it is useful to look at how important international trade has become to us. Trade was the fastest growing part of the world economy in the last decade -- but the volume of U.S. exports grew even faster in the last part of the 1970's, more than twice as fast as the volume of total world exports. By 1980, nearly 20 percent of total U.S. production of goods was being exported, up from 9 percent in 1970, although the proportion has fallen slightly since then. (Charts C and D.)

Among the most dynamic export sectors for this country are agriculture, services, high technology, crude materials and fuels. American agriculture is heavily export-oriented: one in three acres of U.S. agricultural land, and 40 percent of agricultural production, go to exports. This is one sector in which we run a consistent trade surplus, a surplus that grew from \$1.6 billion in 1970 to over \$24 billion in 1980. (Chart E.)

Services trade -- for example, shipping, tourism, earnings on foreign direct investment and lending -- is another big U.S. growth area. The U.S. surplus on services trade grew from \$3 billion in 1970 to \$34 billion in 1980, and has widened further since. (Chart F.) When both goods and services are combined, it is estimated that one-third of U.S. corporate profits derive from international activities.

High technology manufactured goods are a leading edge of the American economy, and not surprisingly net exports of these goods have grown in importance. The surplus in trade in these products rose from \$7.6 billion in 1970 to \$30 billion in 1980. And even in a sector we do not always think of as dynamic -- crude materials and non-petroleum fuels like coal -- net exports rose six-fold, from \$2.4 billion to \$14.6 billion over the same period.

Vigorous expansion of our export sectors has become critical to employment in the United States. (Chart G.) The absolute importance of exports is large enough -- they accounted directly for 5 million jobs in 1982, including one out of every eight jobs in manufacturing industry. But export-related jobs have been getting even more important at the margin. A survey in the late 1970s indicated that four out of every five new jobs in U.S. manufacturing was coming from foreign trade; on average, it is estimated that every \$1 billion increase in our exports results in 24,000 new jobs. Later I will detail how Mexico's debt problems have caused a \$10 billion annual-rate drop in our exports to Mexico between the end of 1981 and the end of 1982. By the rule of thumb I just mentioned, that alone -- if sustained -- would mean the loss of a quarter of a million American jobs.

These figures serve to illustrate the overall importance of exports to the U.S. economy. The story can be taken one step further, to relate it more closely to the present financial situation. Our trading relations with the non-OPEC LDCs have expanded even more rapidly than our overall trade. Our exports to the LDCs, which accounted for about 25 percent of total U.S. exports in 1970, rose to about 29 percent by 1980. (Chart H.)

What these figures mean is that the export sector of our economy -- a leader in creating new jobs -- is tremendously vulnerable to any sharp cutbacks in imports by the non-OPEC LDCs. Yet that is exactly the response to which debt and liquidity problems have been driving them. This is a matter of concern not just to the banking system, but to American workers, farmers, manufacturers and investors as well.

Even on the banking side, there are indirect impacts of concern to all Americans. A squeeze on earnings and capital positions from losses on foreign loans not only would impair banks' ability to finance world trade, but also could ultimately

mushroom into a significant reduction in their ability to lend to domestic customers and an increase in the cost of that lending.

Beyond our obvious interest in maintaining world trade and trade finance, there is another less-recognized U.S. financial interest. The U.S. government faces a potential exposure through Federal lending programs administered by Eximbank and the Commodity Credit Corporation. This exposure -- built in support of U.S. export expansion -- amounted to \$35 billion at the end of 1982, including \$24 billion of direct credits (mostly from Eximbank) and \$11 billion of guarantees and insurance. Argentina, Brazil and Mexico are high on the list of borrowers. Should loans extended or guaranteed under these programs sour, the U.S. Treasury -- meaning the U.S. taxpayer -- would be left with the loss.

All industrial economies, including the American economy, will inevitably bear some of the costs of the balance of payments adjustments LDCs must make and are already making. This adjustment would be much deeper, for both the borrowing countries and for lending countries like the United States, if banks were to pull back entirely from new lending this year. In 1983, for example, a flat standstill would require borrowers to make yet another \$20 to \$25 billion cut in their trade and current account deficits, which would be considerably harder to manage if it came right on the heels of similar cuts they have already made. Further adjustments are needed -- but again the question is one of the size and speed of adjustment. If these countries were somehow to make adjustments of that size for a second consecutive year, the United States and other industrial countries would then have to suffer large export losses once again. At the early stages of U.S. and world economic recovery we are likely to be in this year, a drop in export production of this size could abort the gradual rebuilding of consumer and investor confidence we need for a sustained recovery.

In fact, many borrowers have already taken very difficult adjustment measures to get this far. If they were forced to contemplate a second year of further massive cutbacks in available financing, they could be driven to consider other measures to reduce the burden of their debts. Here potentially lies a still greater threat to the financial system.

When interest payments are more than 90 days late, not only are bank profits reduced by the lost interest income, but they may also have to begin setting aside precautionary reserves to cover potential loan losses. If the situation persisted long enough, the capital of some banks might be reduced.

Banks are required to maintain an adequate ratio between their underlying capital and their assets -- which consist mainly of loans. For some, shrinkage of their capital base would force them to cut back on their assets -- meaning their outstanding loans -- or at least on the growth of their assets -- meaning their new lending. Banks would thus be forced to make fewer loans to all borrowers, domestic and foreign, and they would also be unable to make as many investments in securities such as municipal bonds. Reduced access to bank financing would thus force a cutback in the expenditures which private corporations and local governments can make -- and it would also put upward pressure on interest rates.

The usual perception of international lending is that it involves only a few large banks in the big cities, concentrated in half a dozen states. The facts are quite different. We have reliable information from bank regulatory agencies and Treasury reports identifying nearly 400 banks in 35 states and Puerto Rico that have foreign lending exposures of over \$10 million -- and in all likelihood there are hundreds more banks with exposures

below that threshold but still big enough to make a significant dent in their capital and their ability to make new loans here at home. Banks in most states are involved, and the more abruptly new lending to troubled borrowing countries is cut back, the more likely it is that the fallout from their problems will feed back on the U.S. financial system and weaken our economy.

Resolving the International Financial Problem

Debt and liquidity problems did not come into being overnight, and a lasting solution will also take some time to put into place. We have been working on a broad-based strategy involving all the key players -- LDC governments, governments in the industrialized countries, commercial banks, and the International Monetary Fund. This strategy, which was first outlined in my testimony before the full Banking Committee last December, has five main parts:

First, and in the long run most important, must be effective adjustment in borrowing countries. In other words, they must take steps to get their economies back on a stable course, and to make sure that imports do not grow faster than their ability to pay for them. Each of these countries is in a different situation, and each faces its own unique constraints. But in general, orderly and effective adjustment will not come overnight. The adjustment will have to come more slowly, and must involve expansion of productive investment and exports. In many cases it will entail multi-year efforts, usually involving measures to address some combination of the following problems: rigid exchange rates; subsidies and protectionism; distorted prices; inefficient state enterprises; uncontrolled government expenditures and large fiscal deficits; excessive and inflationary money growth; and interest rate controls which discourage private savings and distort investment patterns. The need for such corrective policies is recognized, and being acted on, by major borrowers -- with the support and assistance of the IMF.

The second element in our overall strategy is the continued availability of official balance of payments financing, on a scale sufficient to help see troubled borrowers through the adjustment period. The key institution for this purpose is the International Monetary Fund. The IMF not only provides temporary balance of payments financing, but also ensures that use of its funds is tied tightly to implementation of needed policy measures by borrowers. It is this aspect -- IMF conditionality -- that makes the role of the IMF in resolving the current debt situation and the adequacy of its resources so important.

IMF resources are derived mainly from members' quota subscriptions, supplemented at times by borrowing from official sources. Assessing the adequacy of these resources over any extended period is extremely difficult and subject to wide margins of error. The potential needs for temporary balance of payments financing depend on a number of variables, including members' current and prospective balance of payments positions, the availability of other sources of financing, the strength of the conditionality associated with the use of IMF resources, and members' willingness and ability to implement the conditions of IMF programs. At the same time, the amount of IMF resources that is effectively available to meet its members' needs at any point in time depends not only on the size of quotas and borrowing arrangements, but also on the currency composition of those resources in relation to balance of payments patterns, and on the amount of members' liquid claims on the IMF which might be drawn. In view of all these variables, assessments of the IMF's "liquidity" -- its ability to meet members' requests for drawings -- can change very quickly.

Still, as difficult as it is to judge the adequacy of IMF resources in precise terms, most factors point in the same direction

at present. The resources now effectively available to the IMF have fallen to very low levels in absolute terms, in relation to broad economic aggregates such as world trade, and in relation to actual and potential use of the IMF.

At present, the IMF has about SDR 22 billion available for lending. However, SDR 16 billion of that total has already been committed under existing IMF programs, leaving only about SDR 7 billion available for new commitments. Given the scope of today's financing problems, requests for IMF programs by many more countries must be anticipated over the next year, and it is likely that the IMF's existing resources will have been fully committed by the end of this year. Thus, within six or seven months the IMF will have exhausted its ability to commit resources to new adjustment programs. I will return to our specific proposals in this area shortly.

The IMF cannot be our only buffer in financial emergencies. It takes time for borrowers to design and negotiate lending programs with the IMF and to develop financing arrangements with other creditors. As we have seen in recent cases, the problems of troubled borrowers can sometimes crystallize too quickly for that process to reach its conclusion -- in fact, the real liquidity crunch came in the Mexican and Brazilian cases before such negotiations even started.

Thus, the third element in our strategy is the willingness of governments and central banks in lending countries to act quickly if necessary to respond to debt emergencies. Recent experience has demonstrated the need to be willing to consider providing immediate and substantial short-term financing -- but only on a selective basis, where system-wide dangers are present -- to tide countries through their negotiations with the IMF and discussions with other creditors. We are undertaking this where necessary, on a case-by-case basis, through ad hoc arrangements among finance ministries and central banks, often in cooperation with the Bank for International Settlements. But it must be emphasized that these lending packages are short-term in nature, designed to last for only a year at most and normally much less, and cannot substitute for IMF resources which are designed to help countries through a multi-year adjustment process.

In fact, IMF resources themselves have only a transitional and supporting role. The overall amount of Fund resources, while substantial, is limited and not in any event adequate to finance all the needs of its members. While we feel that a sizeable increase in IMF resources is essential, this increase is not a substitute for lending by commercial banks. Private banks have been the largest single source of international financing in the past to both industrial and developing countries, and this will have to be the case in the future as well -- including during the crucial period of adjustment.

Thus, the fourth essential element in resolving debt problems is continued commercial bank lending to countries that are pursuing sound adjustment programs. In the last months of 1982 some banks, both in United States and abroad, sought to limit or reduce outstanding loans to troubled borrowers. But an orderly resolution of the present situation requires not only a willingness by banks to "roll over" or restructure existing debts, but also to increase their net lending to developing countries, including the most troubled borrowers, to support effective, non-disruptive adjustment.

The increase in net new commercial bank lending that has been arranged for just three countries -- Brazil, Argentina, and Mexico -- amounts to nearly \$11 billion. For Brazil, the banks have agreed to provide new net lending of \$4.4 billion, which would raise total commercial bank claims on Brazil to an estimated total of \$65 billion. For Argentina, net new lending of \$1.5 billion would raise

claims to around \$25 billion. For Mexico, net new lending of \$5 billion will raise bank claims to something over \$65 billion. Without such continued lending in support of orderly and constructive economic adjustment, the programs that have been formulated with the IMF could not succeed -- and the lenders have a strong self-interest in helping to assure success. It should be noted, however, that new bank lending will be at a slower rate than that which has characterized the last few years -- more in line with the increase in 1982 than what we saw in 1980 or 1981.

The final part of our strategy is to restore sustainable economic growth and to preserve and strengthen the free trading system. The world economy is poised for a sustained recovery: inflation rates in most major countries have receded; nominal interest rates have fallen sharply; inventory rundowns are largely complete.

Solid, observable U.S. recovery is one critical ingredient for world economic expansion. We believe the U.S. recovery is now underway, as evidenced by the recent drop in unemployment and the 3.1 percent increase (preliminary) in U.S. GNP during the first quarter of this year. Establishing credible growth in other industrial economies is also important, and we believe the base for recovery has been laid abroad as well.

However, both we and others must exercise caution at this turning point. Governments must not give in to political pressures to stimulate their economies too quickly through excessive monetary or fiscal expansion. A major shift at this stage could place renewed upward pressure on inflation and interest rates.

In addition, rising protectionist pressures, both in the United States and elsewhere, pose a real threat to global recovery and to the resolution of the debt problem. When one country takes protectionist measures hoping to capture more than its fair share of world trade, other countries will retaliate. The result is that world trade shrinks, and rather than any one country gaining additional jobs, everybody loses. More importantly for current debt problems, we must remember that export expansion by countries facing problems is crucial to their balance of payments adjustment efforts. Protectionism cuts off the major channel of such expansion. That adjustment is essential to restoring problem country debtors to sustainable balance of payments positions and avoiding further liquidity crises -- and as we have seen, it is therefore essential to the economic and financial health of the United States.

The only solution is a stronger effort to resist protectionism. As the world's largest trading nation, the United States carries a major responsibility to lead the world away from a possible trade war. The clearest and strongest signal for other countries would be for the United States to renounce protectionist pressures at home and to preserve its essentially free trade policies. That signal would be followed, and would reinforce, continued U.S. efforts to encourage others to open their markets, and would in turn be reinforced by IMF program requirements for less restrictive trade policies by borrowers.

The Role and Resources of the IMF

I have stressed the role of the International Monetary Fund in dealing with the current financial situation, and now I would like to expand on that point. The IMF is the central official international monetary institution, established to promote a cooperative and stable monetary framework for the world economy. As such, it performs many functions beyond the one we are most concerned with today -- that of providing temporary balance of payments financing in support of adjustment. These include monitoring the appropriateness of its members' foreign exchange

arrangements and policies, examining their economic policies, reviewing the adequacy of international liquidity, and providing mechanisms through which its member governments cooperate to improve the functioning of the international monetary system.

In that context, it becomes clearer that IMF financing is provided only as part of its ongoing systemic responsibilities. Its loans to members are made on a temporary basis in order to safeguard the functioning of the world financial system -- in order to provide borrowers with an extra margin of time and money which they can use to bring their external positions back into reasonable balance in an orderly manner, without being forced into abrupt and more restrictive measures to limit imports. The conditionality attached to IMF lending is designed to assure that orderly adjustment takes place, that the borrower is restored to a position which will enable it to repay the IMF over the medium term. In addition, a borrower's agreement with the IMF on an economic program is usually viewed by financial market participants as an international "seal of approval" of the borrower's policies, and serves as a catalyst for additional private and official financing.

The money which the IMF has available to meet its members' temporary balance of payments financing needs comes from two sources: quota subscriptions and IMF borrowing from its members. The first source, quotas, represents the Fund's main resource base and presently totals some SDR 61 billion, or about \$67 billion at current exchange rates. The IMF periodically reviews the adequacy of quotas in relation to the growth of international transactions, the size of likely payments imbalances and financing needs, and world economic prospects generally.

At the outset of the current quota discussions in 1981, many IMF member countries favored a doubling or tripling of quotas, arguing both that large payments imbalances were likely to continue and that the IMF should play a larger intermediary role in financing them. While agreeing that quotas should be adequate to meet prospective needs for temporary financing, the United States felt that effective stabilization and adjustment measures should lead to a moderation of payments imbalances, and that a massive quota increase was not warranted. Nor did we feel that an extremely large quota increase would be the most efficient way to equip the IMF to deal with unpredictable and potentially major financing problems that could threaten the stability of the system as a whole, and for which the IMF's regular resources were inadequate.

Accordingly, the United States proposed a dual approach to strengthening IMF resources:

- First, a quota increase which, while smaller than many others had wanted, could be expected to position the IMF to meet members' needs for temporary financing in normal circumstances.
- Second, establishment of a contingency borrowing arrangement that would be available to the IMF on a stand-by basis for use in situations threatening the stability of the system as a whole.

This approach has been adopted by the IMF membership, in agreements reached by the major countries in the Group of Ten in mid-January, and by all members at the IMF's Interim Committee meeting early last month.

The agreed increase in IMF quotas is 47 percent, an increase from SDR 61 billion to SDR 90 billion (in current dollar terms, an increase from \$66 billion to \$98 billion). The proposed increase

in the U.S. quota is SDR 5.3 billion (\$5.8 billion at current exchange rates) representing 18 percent of the total increase.

The Group of Ten, working with the IMF's Executive Board, has agreed to an expansion of the IMF's General Arrangements to Borrow from the equivalent of about SDR 6.5 billion at present to a new total of SDR 17 billion, and to changes in the GAB to permit its use, under certain circumstances, to finance drawings on the IMF by any member country. Under this agreement, the U.S. commitment to the GAB would rise from \$2 billion to SDR 4.25 billion, equivalent to an increase of roughly \$2.6 billion at current exchange rates.

We believe this expansion and revision of the GAB offers several important attractions and, as a supplement to the IMF's quotas, greatly strengthens the IMF's role as a backstop to the system:

- First, since GAB credit lines are primarily with countries that have relatively strong reserve and balance of payments positions, they can be expected to provide more effectively usable resources than a quota increase of comparable size. Consequently, expansion of the GAB is a more effective and efficient means of strengthening the IMF's ability to deal with extraordinary financial difficulties than a comparable increase in quotas.
- Second, since the GAB will not be drawn upon in normal circumstances, this source of financing will be conserved for emergency situations. By demonstrating that the IMF is positioned to deal with severe systemic threats, an expanded GAB can provide the confidence to private markets that is needed to ensure that capital continues to flow, thus reducing the risk that the problems of one country will affect others.
- And third, creditors under this arrangement will have to concur in decisions on its activation, ensuring that it will be used only in cases of systemic need and in support of effective adjustment efforts by borrowing countries.

Annex A to my statement contains the texts of the relevant IMF report and decisions on the quota increase and GAB revisions. In sum, the proposed increase in U.S. commitments to the IMF totals SDR 7.7 billion -- SDR 5.3 billion for the increase in the U.S. quota and SDR 2.4 billion for the increase in the U.S. commitment under the GAB. At current exchange rates, the dollar equivalents are \$8.4 billion in total, \$5.8 billion for the quota increase and \$2.6 billion for the GAB increase.

We believe these steps to strengthen the IMF, if enacted, will safeguard the IMF's ability to respond effectively to current financial problems. Given the financing needs that are foreseen, IMF members have agreed that it is important that the increases be implemented by the end of this year. Without such a timely and adequate increase in IMF resources, the ability of the monetary system to weather debt and liquidity problems will be impaired, at substantial direct and indirect cost to the United States.

Concerns about the Increase in IMF Resources

The general outline of our proposals has been known to members of Congress for some time. Many have expressed reservations or questions about this proposal, and I would like to discuss some of the main concerns now.

• Is the IMF "Foreign Aid"?

Many perceive money appropriated for IMF use to be just another form of foreign aid, and question why we should be providing U.S. funds to foreign governments. Let me assure you that the IMF is not a development institution. It does not finance dams, agricultural cooperatives, or infrastructure projects. The IMF is a monetary institution. Only one of its functions is providing balance of payments financing to its members in order to promote orderly functioning of the monetary system, and only then on a temporary basis, on medium-term maturities, after obtaining agreement to the fulfillment of policy conditions. Financing is not provided in one lump sum to borrowing countries, but is made available in parts only as they implement agreed policies. We have been working very hard with the IMF to ensure that both the effectiveness of IMF policy conditions, and the temporary nature of its financing, are safeguarded. In this way, the Fund's financing facilities will continue to have a revolving nature and to promote adjustment.

IMF conditionality has been controversial over the years, with strong opinions on both sides. Some observers have worried that conditionality is so weak and ineffective that conditional lending is virtually a giveaway. Others believe that conditionality is too tight -- that it imposes unnecessary hardship on borrowers, and stifles economic growth and development.

Such generalizations reflect a misunderstanding of IMF conditionality. When providing temporary resources to a country faced with external financing problems, the IMF seeks to assure itself that the country is pursuing policies that will enable it to live within its means -- that is, within its ability to obtain foreign financial resources. It is this that determines the degree of adjustment that is necessary. It is often the case that appropriate economic policies will strengthen a country's borrowing capacity, and result in both higher import growth and higher export growth. I would cite the example of Mexico as an immediate case in point.

Mexico is our third largest trading partner, after Canada and Japan. And, as recently as 1981, it was a partner with whom we had an export boom and a substantial trade surplus, exporting goods to meet the demands of its rapidly growing population and developing economy. This situation changed dramatically in 1982, as Mexico began experiencing severe debt and liquidity problems. By late 1982, Mexico no longer had access to financing sufficient to maintain either its imports or its domestic economic activity. As a result, U.S. exports to Mexico dropped by a staggering 60 percent between the fourth quarter of 1981 and the fourth quarter of 1982. Were our exports to Mexico to stay at their depressed end-1982 levels, this would represent a \$10 billion drop in exports to our third largest market in the world. Because the financing crunch got worse as the year wore on, totals for the full year 1982 don't tell the story quite so dramatically -- but even they are bad enough. Our \$4 billion trade surplus with Mexico in 1981 was transformed into a trade deficit of nearly \$4 billion in 1982, due mainly to an annual-average drop in U.S. exports of one-third. (Chart I.) This \$8 billion deterioration was our worst swing in trade performance with any country in the world, and it was due almost entirely to the financing problem.

We believe that now this situation will start to turn around, and we can begin to resume more normal exports to Mexico. If this happens, it will be due in large part to the fact that, late in December, an IMF program for Mexico went into effect; and that program is providing the basis not only for IMF financing, but for other official financing and for a resumption of commercial bank lending as well. Mexico must make difficult policy adjustments if it is to restore creditworthiness. The Mexican authorities realize this and are embarked on a courageous program. But the existence of IMF financing and the other financing associated

with it will permit Mexico to resume something more like a normal level of economic activity and imports while the adjustment takes place in an orderly manner. Without the IMF program, all we could look forward to would be ever-deepening depression in Mexico and still further declines in our exports to that country.

There is another aspect of the distinction between IMF financing and foreign aid which we should be very clear on, since it goes to the heart of U.S. relations with the Fund. All IMF members provide financing to the IMF under their quota subscriptions, and all -- industrial and developing alike -- have the right to draw on the IMF. Quota subscriptions form a kind of revolving fund, to which all members contribute and from which all are potential borrowers.

As an illustration, in practice our quota subscription has been drawn upon many times -- and repaid -- over the years for lending to other IMF members. We in turn have drawn on the IMF on 24 occasions -- most recently in November 1978 -- and our total cumulative drawings, amounting to the equivalent of \$6.5 billion, are the second largest of any member (the United Kingdom has been the largest user of IMF funds). (U.S. drawings on the IMF are described at Annex B.)

* Do IMF Programs Promote Protectionism and Hurt U.S. Exports?

There is a perception that IMF programs are designed to cut imports and growth in borrowing countries; and that the IMF encourages protectionist measures as a means to reduce imports. More generally, it is argued by some that, far from helping to maintain world trade and U.S. exports, IMF programs actually hurt exports by the United States and other industrial countries by reducing overall import demand in borrowing countries.

Both of these arguments are just plain wrong. The purpose of an IMF program is to restore a borrower's external position to a sustainable basis -- but that doesn't take place solely, or in the long run even primarily, by restraining imports. In fact, it is frequently the case that a country's imports under an IMF program are higher than in the period before that program went into effect -- and generally far higher than would have been possible in the absence of the program.

The logic of this process should be clear. By the time many countries approach the Fund, they have permitted economic and financial conditions to deteriorate to such an extent that their access to normal sources of credit is severely restricted, if not cut off altogether. Without the policy reforms instituted under an IMF program, the temporary financing the IMF makes available, and the additional private and official financing its program catalyzes, imports and economic activity would be curtailed sharply; adjustment would be abrupt and disorderly. We saw this happen in Mexico last year, before its IMF program was put in place.

In contrast, with an IMF program a borrowing country receives additional financing which enables it to maintain higher levels of growth and imports, even when it is putting strong adjustment measures in place. In the longer run as well, a successful program makes a higher level of imports and a higher economic growth rate possible. For as I have said earlier, orderly adjustment entails not just the cooling of overheated demand, but also a wide range of measures to increase a borrowing country's economic efficiency and productive capacity, and hence its ability to grow and to pay for imports.

In fact, this conclusion is borne out vividly by the performance envisioned under 26 new IMF conditional adjustment programs

-- 23 recently approved, and three proposed. In the great majority of these, real economic growth is expected to improve in the first year of the program as compared with the preceding two years; growth is expected to decline in the first year in only 7 of the 26. The same is true for imports under these Fund programs: imports are expected to be higher in the first program year than in the two preceding years in 19 out of 26 cases.

The programs for Mexico, Argentina, and Brazil all fit this category. In Mexico the real economic growth rate fell from 8.1 percent in 1981 to zero in 1982; and imports fell from \$23 billion in 1981 to less than \$15 billion in 1982. Since the vast majority of Mexico's imports come from the United States, Mexico's ability to import in the future matters quite a lot to us. In the first year of the new IMF program, Mexico's imports are projected to rise by 2 percent, and by another 14 percent next year.

In Argentina real GNP declined for two years preceding the IMF program, and imports dropped from \$9.4 billion in 1981 to \$5.5 billion in 1982. Under the IMF program, Argentina's imports are projected to rise by 18 percent over two years and real growth is expected to resume. In Brazil, real GDP fell 3.5 percent in 1981 and stagnated in 1982, while imports dropped from \$22 billion in 1981 to \$19.4 billion in 1982. Brazil's imports are expected to decline significantly further this year, but to grow over the course of their three-year IMF program as a whole; indeed, excluding oil, Brazil's imports in the third program year are projected to be some 35 percent higher than last year. Clearly, not all IMF programs can lead to increased imports in the short run, especially where imports were unsustainably high beforehand. But IMF programs do permit a higher short-run import level than would be possible without a program, and are always designed to lead to longer-term increases.

The suggestion that the IMF encourages trade protectionism as a means of balance of payments adjustment does not stand up under scrutiny either. The entire history and philosophy of the organization run in the opposite direction -- toward a free and open trading system -- as do its practices. It aims at liberalizing trade policies as far as possible in order to minimize economic distortions and stimulate competition. For this purpose, the performance criteria in IMF programs always include an injunction against the imposition or intensification of import or payments restrictions for balance of payments reasons. If actions are taken which violate these prohibitions, the borrower is prevented from using additional IMF credit until the issue can be resolved satisfactorily to the Fund.

In fact, these performance criteria designed to avoid increased protectionism are only half the story. The other half is that the IMF also actively seeks the reduction and elimination of existing import restrictions and export subsidies by providing for the adoption of more efficient, market-oriented measures during program periods. Among the 38 Fund programs approved between January 1, 1982, and February 28, 1983, 30 included some positive reform or liberalization of a country's exchange or trade system.

* Why Not Spend the Money at Home?

Another major concern with the proposals to increase IMF resources is that, in this period of budgetary stringency, many believe we would be better advised to spend the money at home. There is also some feeling that if we were to get the U.S. economy moving forward again, the international financial problem would take care of itself. I think I've already been through part of the response to these concerns when I described the large and growing impact which foreign trade now has on American growth and employment. We will do what is necessary domestically to strengthen

our economy. But we will leave a major threat to domestic recovery unaddressed if we do not act to resolve the international financial situation. The direct impact alone of international developments on our economy is so large that, were the international situation not to improve, there would at a minimum be a tremendous drag on our economic recovery.

It is true that an improving U.S. economy is going to help other nations, both through our lower interest rates and through an expanding U.S. market for their exports -- providing of course that we don't cut them off from that market. But they also have an immediate, short-run financing crunch to get through, and if we don't handle that right there are substantial downside risks for the United States.

• Budgetary Treatment

This might also be the right context in which to discuss how U.S. participation in the increase in IMF resources would affect the Federal budget and the Treasury's borrowing requirements. Under budget and accounting procedures adopted in connection with the last IMF quota increase, in consultation with the Congress, both the increase in the U.S. quota and the increase in U.S. commitments under the GAB will require Congressional authorization and appropriation. However, because the United States receives a liquid, interest-earning reserve claim on the IMF in connection with our actual transfers of cash to the IMF, such transfers do not result in net budget outlays or an increase in the Federal budget deficit.

Actual cash transactions with the IMF, under our quota subscription or U.S. credit lines, do affect Treasury borrowing requirements as they occur. The amount of such transactions in any given year depends on a variety of factors, including the rate at which IMF resources are used; the degree to which the dollar in particular is involved in both current IMF drawings and repayments of past drawings; and whether the United States itself draws on the IMF.

An analysis appended to this statement at Annex C presents data on the impact of U.S. transactions with the IMF between U.S. fiscal year 1970 and the first quarter of fiscal 1983 on Treasury borrowing requirements. Although there have been both increases and decreases in Treasury borrowing requirements from year to year, on average there have been increases amounting to about \$1/2 billion annually over the entire period, for a cumulative total of about \$7 billion. The rate has picked up in the last two years of heavy IMF activity, as would be expected; but the total is still relatively small -- the \$1/2 billion annual impact is only a small part of the \$61 billion annual average increase in Treasury borrowing over the same period, and the roughly \$7 billion cumulative impact compares with an outstanding Federal debt of \$1.1 trillion at the end of fiscal 1982. These figures also serve to demonstrate the revolving nature of the IMF.

• Is the IMF a Bank "Bail-Out"?

I also know there is a widespread concern that an increase in IMF resources will amount to a bank bail-out at the expense of the American taxpayer. Many would contend that the whole debt and liquidity problem is the fault of the banks -- that they've dug themselves and the rest of us into this hole through greed and incompetence, and now we intend to have the IMF take the consequences off their hands. This line of argument is dangerously misleading, and I would like to set the record straight.

First, the steps that are being taken to deal with the financial problem, including the increase in IMF resources, require

continued involvement by the banks. Far from allowing them to cut and run, orderly adjustment requires increased bank lending to troubled LDCs that are prepared to adopt serious economic programs. That is exactly what is happening.

And it is not a departure from past experience. I have had Treasury staff review IMF program experience in the 20 countries which received the largest net IMF disbursements in the last few years, to see whether banks had been "bailed out" in the past. Looking at the period from 1977 to mid-1982, they found that for the countries which rely most heavily on private bank financing, IMF programs have been followed up by new bank lending much greater than the amount disbursed by the Fund itself. This also holds true for the 20 countries as a group: net IMF disbursements to this group during the period were \$11.5 billion, while net bank lending totalled \$49.7 billion, resulting in a ratio of 4.3 to 1 during this period.

It is clear that IMF resources are not being used to enable banks to pull out of lending to troubled countries. But a question is frequently raised about how IMF financing is used. The correct, if rather broad, answer is that it is used for general balance of payments support.

One must remember that many of the countries now undertaking IMF programs have previously reached a stage where financing was no longer available to them to allow them to conduct normal international transactions. IMF financing is provided to member governments to enable them to resume such transactions while adjustment is taking place. There are a wide variety of specific international transactions which governments themselves engage in, including merchandise imports, purchases of services from abroad, and various capital transactions. Some, but only a part, of these transactions are related to interest on, and repayments of, past borrowing from commercial banks. In addition, in most developing countries the foreign exchange market is so small and rudimentary that it is managed by the government or central bank. As a result, demands for foreign exchange resources of the type provided by IMF financing must also be met by LDC governments in facilitating a large variety of transactions related to imports, purchases of services, and capital transactions by private citizens -- a function which in the United States is performed by private foreign exchange markets. Because money is fungible it is neither possible nor meaningful to ascribe the financing provided by the IMF to any particular subset of a borrowing country's balance of payments transactions.

Another point I would like to make is that the whole debt and liquidity problem cannot fairly be said to be the fault of the commercial banks. In fact, the banking system as a whole performed admirably over the last decade, in a period when there were widespread fears that the international monetary system would fall apart for lack of financing in the aftermath of the oil shocks. The banks managed almost the entire job of "recycling" the OPEC surplus and getting oil importers through that difficult period. Some of the innovations and decisions that banks made in the process, which seemed rational and necessary at the time to them and to others, may seem doubtful in retrospect, given the way the world economic environment changed. But I think we can agree that governments have had a great deal more to do with shaping that environment than banks.

These remarks are not intended to absolve the banks of any blame. We have been examining what banks -- and banks regulators -- should do to improve on their practices and procedures. The primary role of bank regulation is and must continue to be ensuring the safety and soundness of the banking system, but

this must evolve in concert with the dynamics of domestic and international financial developments.

In considering possible changes to regulatory practices, several points should be borne in mind which militate against drastic changes. One is that "safety and soundness" is not necessarily best achieved through rigid limits or abrupt adjustments. Customers which are temporarily illiquid but not insolvent may merit additional funds, and the system as a whole could suffer if banks were unduly discouraged from extending such new credits. I believe that there is at present little danger of a resurgence of bank lending to LDCs at imprudent rates. There is a relatively greater danger that some banks will seek to avoid participating in the moderate increase in new net lending that forms one pillar of the five-point strategy I have previously set forth.

A second consideration is that the government should not relieve the banks of responsibility for lending decisions. It is bank managements, which have direct experience with the borrowers and a responsibility to their shareholders and depositors, that are in the best position to make lending decisions.

A third consideration is that U.S. banks do not operate in isolation from their peers -- and competitors -- in other countries. It is impractical and unnecessary to achieve an identity of regulatory practices internationally, but some consistency among regulatory regimes is desirable.

Debate over possible changes to our regulatory framework has focused on areas such as the adequacy of the existing system for evaluating country risk and identifying concentrations, greater disclosure and more frequent reporting, the possibility of special reserves for problem loans, the accounting for fee income, and the adequacy of capital of banks. This debate is healthy, and I commend the Congress for encouraging it and for advancing a number of proposals. It has been greatly assisted as well by the submission of a Joint Memorandum on April 7 from the three bank regulatory agencies, and by their subsequent preparation, in response to a Congressional request, of draft legislation which would provide a legal mandate to implement the program set forth in the Joint Memorandum. These proposals have been included in legislation reported by the Banking Committees of both Houses.

This debate deals with a sensitive and central part of our economy. The decisions taken will have important implications both for resolving the present situation and for the evolution of the banking system in the future. I am hopeful that its outcome will be one of constructive and evolutionary changes that are consistent with the principles I have discussed.

Possible Alternatives

Finally, there have been various proposals for basic alternatives to the IMF quota increase or, indeed, to the general strategy that has been adopted to deal with the debt situation. These generally involve use of IMF gold as a substitute or partial substitute for the quota increase, some kind of generalized system of debt relief, or a large scale write-off of debt. I do not believe these offer realistic or desirable alternatives to the approach being followed or to the proposed increase in IMF resources.

Use of IMF Gold. Several proposals have been advanced for "mobilization" of some or all of the IMF's gold holdings, either as an alternative to the agreed increase in quotas and expansion of the GAB, or in conjunction with those measures. These proposals vary, but generally envisage:

- sales of gold to the private market, with the proceeds used to finance regular IMF operations;
- sales of gold to members at the old official price of SDR 35 per ounce (now about \$38) in proportion to their quotas in August 1975 -- under the so-called gold "restitution" provisions;
- loans of gold to members;
- use of the gold as collateral for IMF borrowing in private markets.

Any decision to sell IMF gold requires an 85 percent majority vote; the IMF has no authority to lend gold to its members.

From the point of view of the IMF, it would have to sell its entire gold stock of 103 million ounces to generate the roughly \$42 billion total agreed for the quota and GAB increase. This is not realistic. Such sales over a period of a few years would probably depress the price in a major way, perhaps dramatically. An effort to stretch the sales out over an extended period, in order to minimize the price effects, would leave the IMF without the resources to finance prospective commitments in the more immediate future.

Similarly, proposals to "restitute" IMF gold, through sales to members at the old official price, would simply deplete the Fund's resources. Even if all the gold were sold in this way, the IMF would obtain the equivalent of only about \$4 billion. Moreover, the countries experiencing the greatest financial problems would receive little benefit -- far less than they could borrow from the IMF, under appropriate conditionality, with the proposed increase in IMF resources. Restitution would essentially represent a windfall for the wealthier IMF members, not a contribution to resolution of the debt situation.

At present, all IMF assets, including the IMF's gold, serve as backing for creditors' claims on the Fund. Such claims currently total about \$35 billion, including U.S. claims of \$9.4 billion. These claims are liquid, and the existence of the Fund's gold reserve assures that these claims can be met if they are encashed. It is extremely unlikely that current IMF creditors would be willing to have this security eliminated as a result of IMF gold sales or subordinated to IMF pledges of gold to other lenders.

For these reasons, any international discussions of the use of IMF gold would be contentious and protracted, and it is extremely unlikely that the 85 percent majority vote that would be needed could be obtained for a decision to sell all or a substantial part of the IMF's gold. The creditors do not want their security impaired; and neither the creditors nor the borrowers want to see the IMF's resources depleted.

From the United States' own point of view, the economic and financial effects of gold sales could far outweigh any costs associated with Treasury borrowings in connection with the proposed quota increase. First, the U.S. is the single largest IMF creditor today, with claims on the IMF totaling over \$9.4 billion. Sales of the gold and use of the proceeds for IMF lending would remove this security for our claims.

Second, major IMF gold sales could lead to a dramatic drop in gold prices and reduce the potential value of our own gold holdings, about \$115 billion at current market prices. A price drop of only \$32 an ounce -- a small amount in the volatile gold market -- would totally offset the \$8.4 billion proposed for increase in U.S. participation in the IMF. A very substantial

price drop, which would seem more likely in the face of large-scale IMF gold sales, would have serious adverse consequences for domestic gold producers and precipitate large losses on the gold stocks of the United States and other countries.

Third, the sale of IMF gold would not eliminate the financial market effects that concern some in connection with the quota increase and Treasury borrowing. The gold would be acquired by investors, in part financed through sales of U.S. corporate or Treasury securities. This would put pressures on interest rates and financial markets similar to, and possibly greater than, those arising from any U.S. borrowing in connection with the quota increase.

From a broader perspective, the IMF is central to the agreed strategy for dealing with current problems in a way supportive of U.S. economic and foreign policy interests. After more than two years of negotiation, international agreement has been reached on measures to insure that the IMF has adequate resources to fulfill its responsibilities. An effort by the United States to alter this agreement and, in effect, to deplete the IMF's assets instead, would be strongly and appropriately rebuffed by other countries, with devastating consequences for international confidence in U.S. leadership.

Generalized Rescheduling of Debts. Proposals for generalized debt rescheduling fail to recognize the very substantial restructuring of debt that is already taking place or to distinguish among the very different situations of borrowing countries. Of the twenty largest LDC borrowers, accounting for 85 percent of total LDC debt to banks, some eight countries -- accounting for nearly 60 percent of the total -- have major restructurings in place or in progress. Many other countries do not appear to require rescheduling at this time and want to meet their obligations in a timely manner.

Generalized systems of debt relief are not needed or appropriate. Economic adjustment in borrowing countries is essential to resolving the debt problem and avoiding a recurrence; but these proposals would relieve many borrowers of essential pressure to adjust. Under some variants, they could create major disincentives for lenders to provide needed credit in the future; under others, there would be high costs for governments and taxpayers. Reschedulings and restructurings are taking place under the current strategy, but in a selective manner tailored to individual circumstances, so as to minimize disincentives to needed adjustment and private financing and to avoid undue cost to the taxpayer.

Debt Write-Offs. The assumption underlying proposals for large-scale write-offs of debt is that there is no hope of restoring orderly debt servicing and creditworthiness in many or most LDC borrowers. I do not agree with the basic assumption. The major borrowers -- many admittedly over-extended today, with their export markets impaired by recession -- resemble in important ways the developing U.S. economy of the 1800s. They require large amounts of capital to develop and grow. With proper policies and a reasonably stable world environment, their economies, their capacity to earn foreign exchange and their ability to service debt will all expand. Most or all should, with effort and discipline, again become creditworthy.

Mandatory large-scale write-offs would almost certainly cut off any future flow of new funds to LDCs and could induce banks to try to reduce their current exposure -- making it virtually impossible for borrowers to adjust in an orderly and constructive way and putting enormous pressure on governments to pick up the financing burden. And major write-offs, by forcing the banks to take heavy losses which would wipe out their capital resources

in the process, would cause the banking system to curtail domestic lending as well, tightening credit markets, raising interest rates and threatening our recovery.

Conclusion

The IMF plays a crucial role in the solution to current debt and liquidity problems, and in providing the environment for world recovery. It is absolutely essential that the proposed increase in IMF resources become effective by the end of this year, to enable the IMF to meet these responsibilities. Prompt U.S. approval is important not only because the financing is needed, but also because it would be a sign of confidence to other governments and to the public, and would help lay to rest concerns about the risks to global recovery posed by the international debt problem.

But most importantly, timely approval of these proposals is essential to our own economic interests -- to the prospects for American businesses and American jobs. I urge that you give the proposed legislation prompt and favorable consideration.

Chart A
OUTSTANDING FOREIGN DEBT OF NON-OPEC LDCs

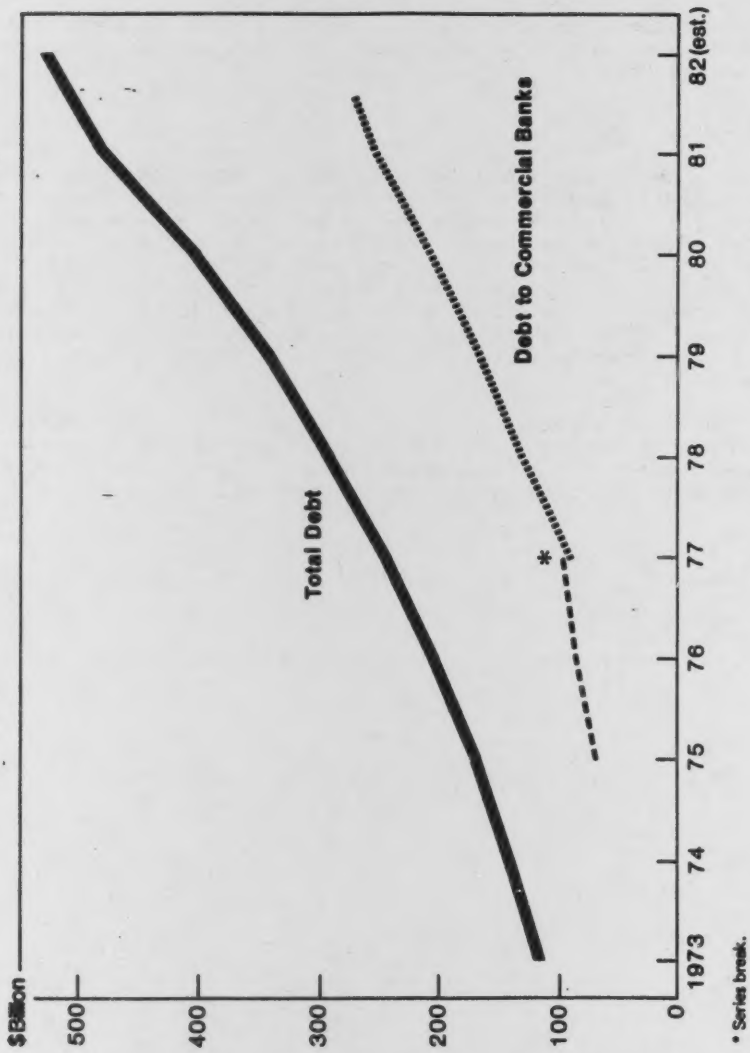


Chart B

NET NEW LENDING BY COMMERCIAL BANKS TO NON-OPEC LDCs

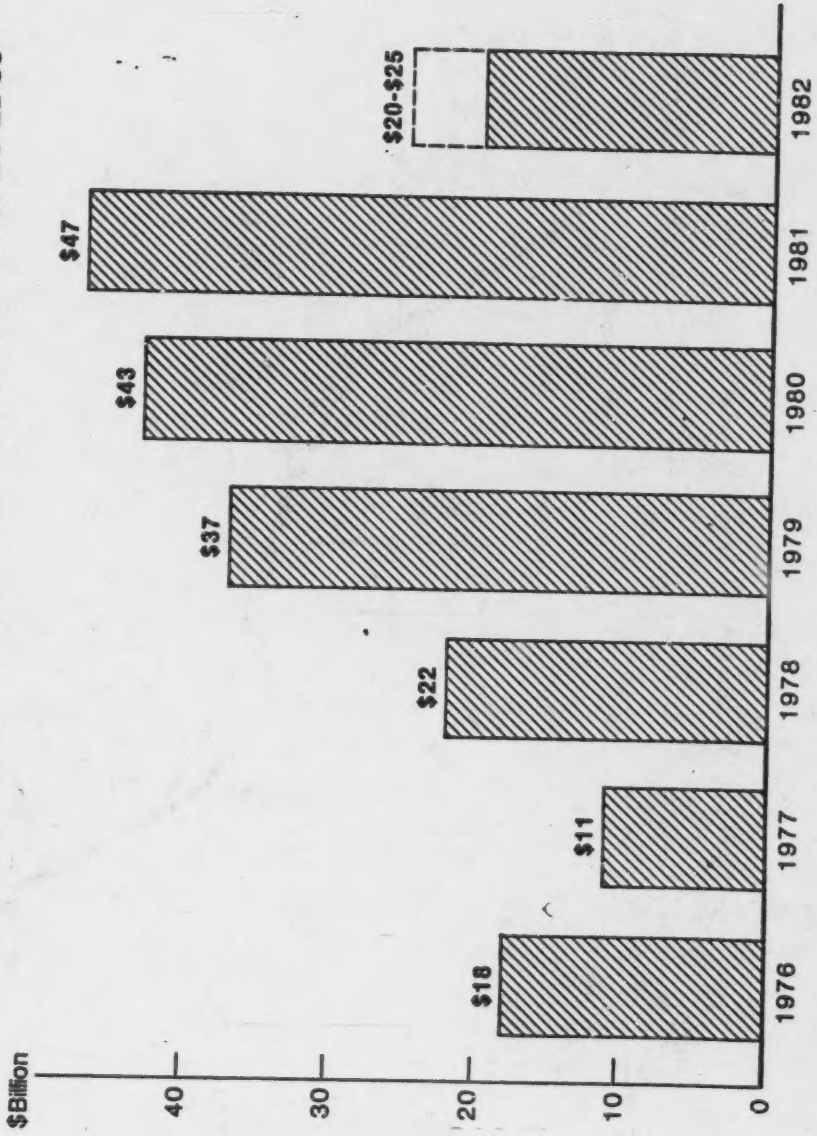


Chart C
GROWTH OF U.S. AND WORLD EXPORT VOLUME

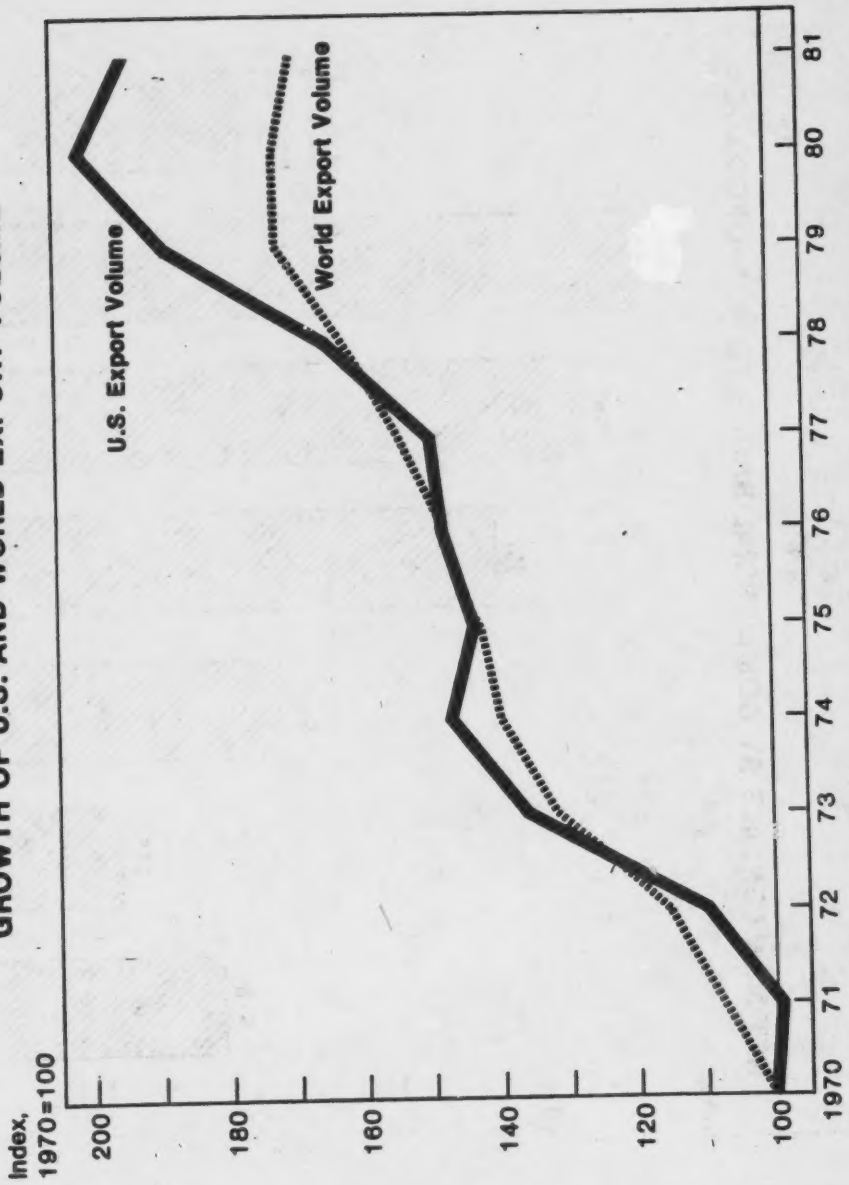


Chart D
**SHARE OF U.S. EXPORTS
IN TOTAL U.S. GOODS OUTPUT**

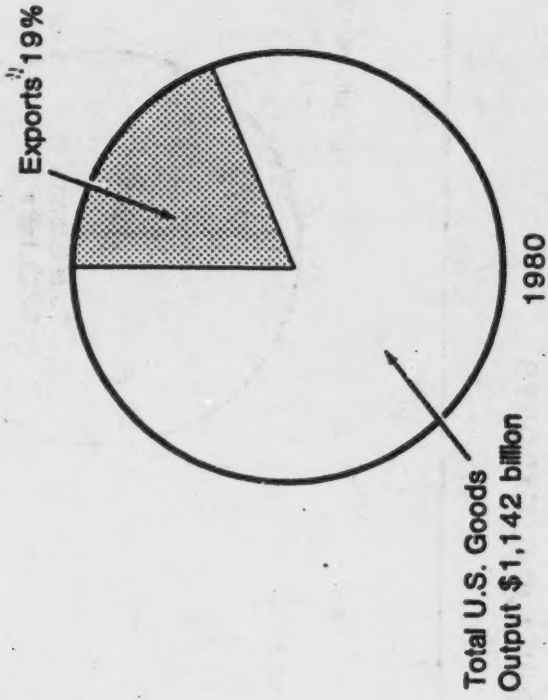
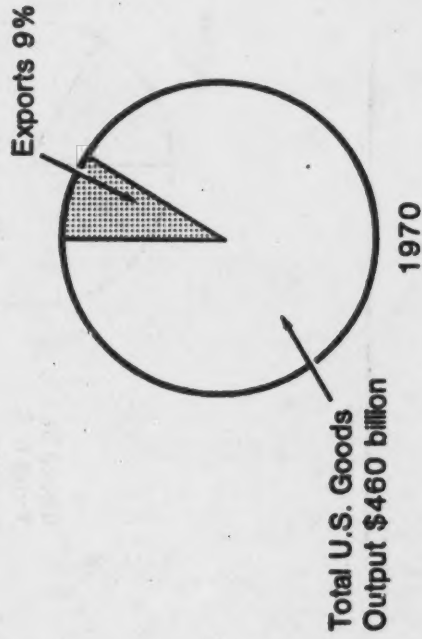
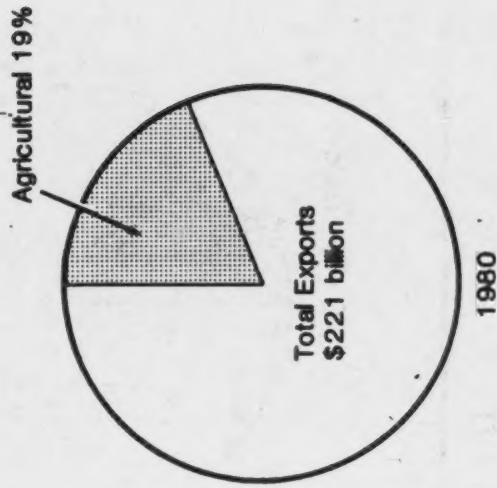
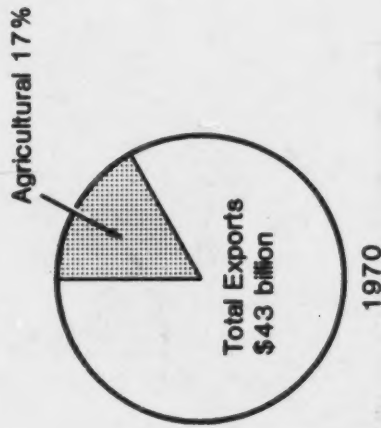


Chart E

U.S. AGRICULTURAL EXPORTS



Surplus of \$24.3 billion



Surplus of \$1.6 billion

Share in
Total U.S.
Exports:

Net U.S.
Agricultural
Trade
Balance:

Chart F
U.S. TRADE BALANCE IN SERVICES

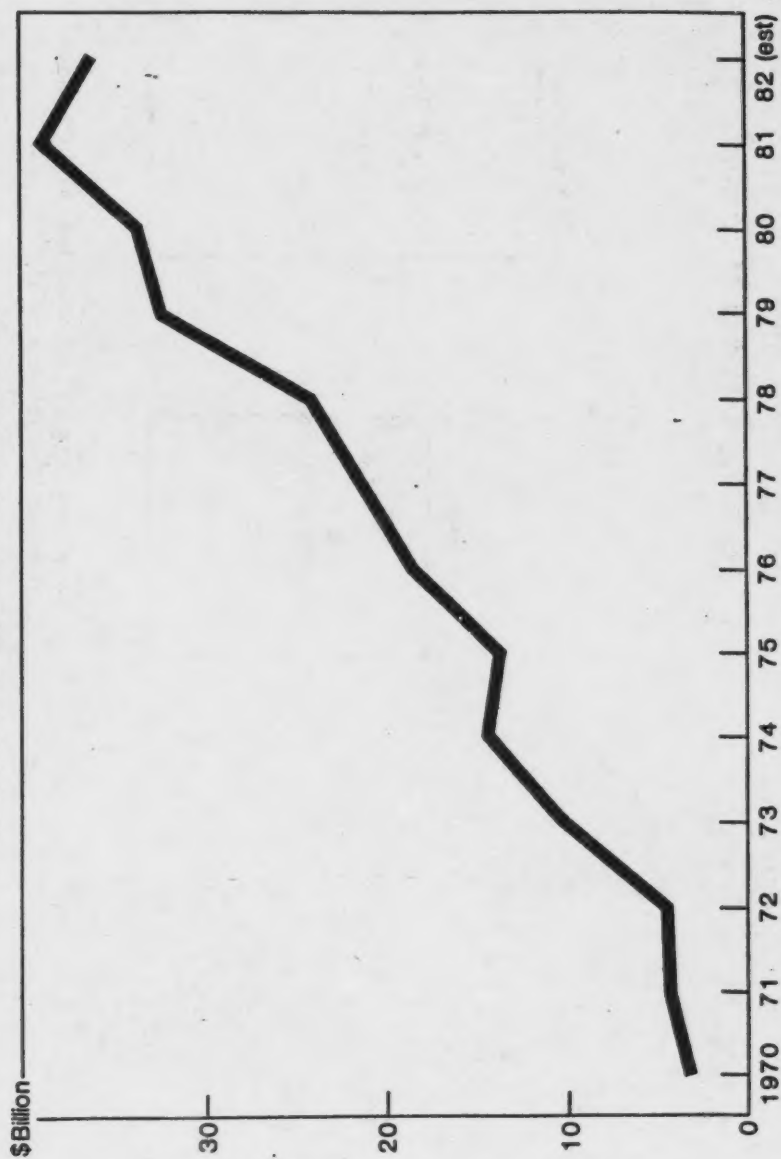
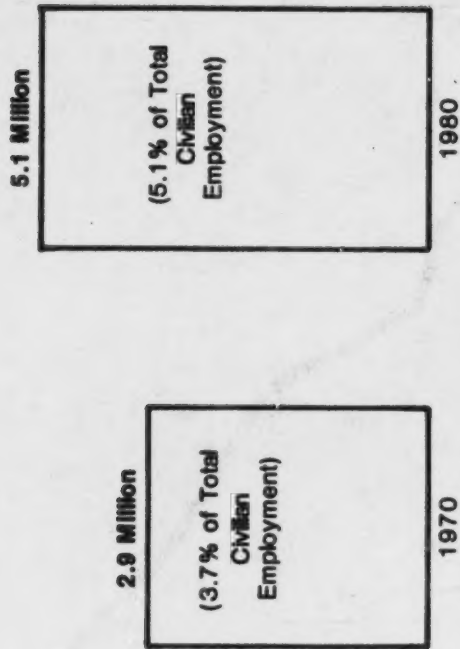


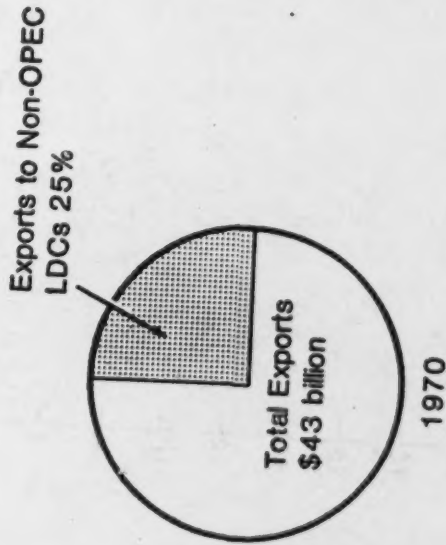
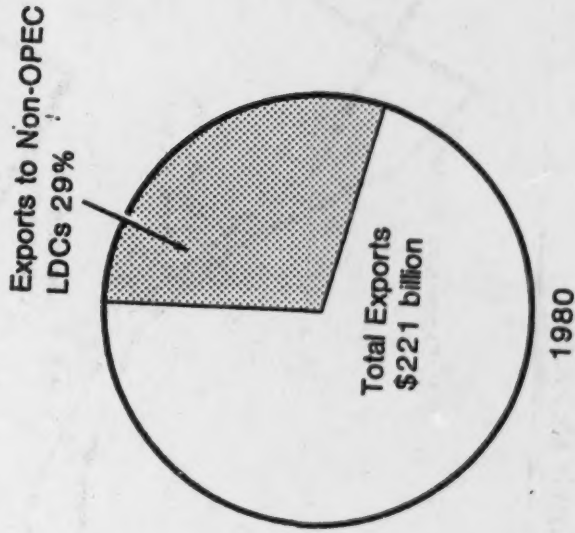
Chart G

U.S. EXPORT-RELATED JOBS

As of 1980, each \$1 billion of U.S. exports was estimated to result in 24,000 jobs.

Source: Commerce Department (ITA) estimates.

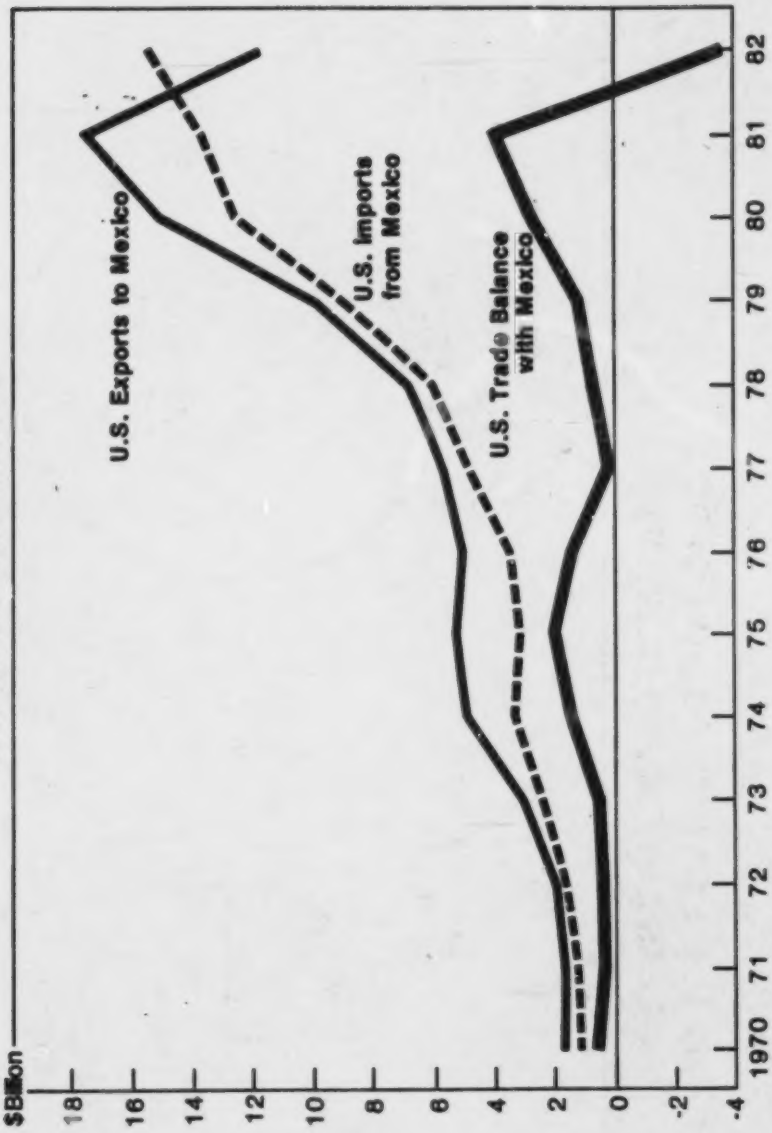
Chart H

**U.S. EXPORTS TO NON-OPEC
LESS DEVELOPED COUNTRIES**

Share in
Total U.S.
Exports

Chart I

U.S. TRADE WITH MEXICO



INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 83/19

FOR IMMEDIATE RELEASE
March 1, 1983

The Executive Board of the International Monetary Fund has completed the work necessary to enable a revision and enlargement of the General Arrangements to Borrow (GAB), which had recently been agreed in principle by the Group of Ten and the Fund. The main change is a substantial increase to SDR 17 billion in the credit arrangements available to the Fund from the present size of approximately SDR 6.4 billion. Other amendments to the existing GAB provisions will (i) permit the Fund to borrow under the enlarged credit arrangements to finance exchange transactions with members that are not GAB participants, (ii) authorize Swiss participation and (iii) permit certain borrowing arrangements between the Fund and non-participating members to be associated with the GAB, with the possibility that the Fund could activate the GAB as if the associated lenders were GAB participants.

The changes will become effective when all ten participants--Belgium, Canada, Deutsche Bundesbank, France, Italy, Japan, Netherlands, Sveriges Riksbank, United Kingdom and the United States--have notified the Fund in writing that they concur in the amendments and in the increased credit commitments. Participants are asked to do so by December 31, 1983. Swiss participation will become effective when the amended decision has become effective.

Under the GAB, which became effective on October 24, 1962, ten industrial members extended credit lines to the Fund. The arrangements have been periodically renewed, with some modifications, and in one case, that of Japan, the original amount of the credit line has been increased.

The Fund will continue to be able to call on GAB resources for any drawings by participants when supplementary resources are needed to forestall or cope with an impairment of the international monetary system. As soon as the revision to the GAB becomes effective, the Fund may also call on GAB resources to finance drawings by Fund members that are not participants provided those transactions are made under policies of the Fund requiring adjustment programs. Calls on the GAB will be made, in respect of non-participants, if the Fund faces an inadequacy of resources to meet actual and expected requests for financing that reflect the existence of an exceptional situation associated with balance of payments problems of members that would threaten the stability of the international monetary system.

The revised Decision on the GAB and an annex showing the participants and amounts of credit arrangements under both the existing and the future GAB are attached.

GENERAL ARRANGEMENTS TO BORROW

Preamble

In order to enable the International Monetary Fund to fulfill more effectively its role in the international monetary system, the main industrial countries have agreed that they will, in a spirit of broad and willing cooperation, strengthen the Fund by general arrangements under which they will stand ready to make loans to the Fund up to specified amounts under Article VII, Section 1 of the Articles of Agreement when supplementary resources are needed to forestall or cope with an impairment of the international monetary system. In order to give effect to these intentions, the following terms and conditions are adopted under Article VII, Section 1 of the Articles of Agreement.

Paragraph 1. Definitions

As used in this Decision the term:

(i) "Articles" means the Articles of Agreement of the International Monetary Fund;

(ii) "credit arrangement" means an undertaking to lend to the Fund on the terms and conditions of this Decision;

(iii) "participant" means a participating member or a participating institution;

(iv) "participating institution" means an official institution of a member that has entered into a credit arrangement with the Fund with the consent of the member;

(v) "participating member" means a member of the Fund that has entered into a credit arrangement with the Fund;

(vi) "amount of a credit arrangement" means the maximum amount expressed in special drawing rights that a participant undertakes to lend to the Fund under a credit arrangement;

(vii) "call" means a notice by the Fund to a participant to make a transfer under its credit arrangement to the Fund's account;

(viii) "borrowed currency" means currency transferred to the Fund's account under a credit arrangement;

(ix) "drawer" means a member that purchases borrowed currency from the Fund in an exchange transaction or in an exchange transaction under a stand-by or extended arrangement;

(x) "indebtedness" of the Fund means the amount it is committed to repay under a credit arrangement.

Paragraph 2. Credit Arrangements

A member or institution that adheres to this Decision undertakes to lend its currency to the Fund on the terms and conditions of this Decision up to the amount in special drawing rights set forth in the Annex to this Decision or established in accordance with Paragraph 3(b).

Paragraph 3. Adherence

(a) Any member or institution specified in the Annex may adhere to this Decision in accordance with Paragraph 3(c).

(b) Any member or institution not specified in the Annex that wishes to become a participant may at any time, after consultation with the Fund, give notice of its willingness to adhere to this Decision, and, if the Fund shall so agree and no participant object, the member or institution may adhere in accordance with Paragraph 3(c). When giving notice of its willingness to adhere under this Paragraph 3(b) a member or institution shall specify the amount, expressed in terms of the special drawing right, of the credit arrangement which it is willing to enter into, provided that the amount shall not be less than the amount of the credit arrangement of the participant with the smallest credit arrangement.

(c) A member or institution shall adhere to this Decision by depositing with the Fund an instrument setting forth that it has adhered in accordance with its law and has taken all steps necessary to enable it to carry out the terms and conditions of this Decision. On the deposit of the instrument the member or institution shall be a participant as of

the date of the deposit or of the effective date of this Decision, whichever shall be later.

Paragraph 4. Entry into Force

This Decision shall become effective when it has been adhered to by at least seven of the members or institutions included in the Annex with credit arrangements amounting in all to not less than the equivalent of five and one-half billion United States dollars of the weight and fineness in effect on July 1, 1944.

Paragraph 5. Changes in Amounts of Credit Arrangements

The amounts of participants' credit arrangements may be reviewed from time to time in the light of developing circumstances and changed with the agreement of the Fund and all participants.

Paragraph 6. Initial Procedure

When a participating member or a member whose institution is a participant approaches the Fund on an exchange transaction or stand-by or extended arrangement and the Managing Director, after consultation, considers that the exchange transaction or stand-by or extended arrangement is necessary in order to forestall or cope with an impairment of the international monetary system, and that the Fund's resources need to be supplemented for this purpose, he shall initiate the procedure for making calls under Paragraph 7.

Paragraph 7. Calls

(a) The Managing Director shall make a proposal for calls for an exchange transaction or for future calls for exchange transactions under a stand-by or extended arrangement only after consultation with Executive Directors and participants. A proposal shall become effective only if it is accepted by participants and the proposal is then approved by the Executive Board. Each participant shall notify the Fund of the acceptance of a proposal involving a call under its credit arrangement.

(b) The currencies and amounts to be called under one or more of the credit arrangements shall be based on the present and prospective balance of payments and reserve position of participating members or members whose institutions are participants and on the Fund's holdings of currencies.

(c) Unless otherwise provided in a proposal for future calls approved under Paragraph 7(a), purchases of borrowed currency under a stand-by or extended arrangement shall be made in the currencies of participants in proportion to the amounts in the proposal.

(d) If a participant on which calls may be made pursuant to Paragraph 7(a) for a drawer's purchases under a stand-by or extended arrangement gives notice to the Fund that in the participant's opinion, based on the present and prospective balance of payments and reserve position, calls should no longer be made on the participant or that calls should be for a smaller amount, the Managing Director may propose to other participants that substitute amounts be made available under their credit arrangements, and this proposal shall be subject to the procedure of Paragraph 7(a). The proposal as originally approved under Paragraph 7(a) shall remain effective unless and until a proposal for substitute amounts is approved in accordance with Paragraph 7(a).

(e) When the Fund makes a call pursuant to this Paragraph 7, the participant shall promptly make the transfer in accordance with the call.

Paragraph 8. Evidence of Indebtedness

(a) The Fund shall issue to a participant, on its request, non-negotiable instruments evidencing the Fund's indebtedness to the participant. The form of the instruments shall be agreed between the Fund and the participant.

(b) Upon repayment of the amount of any instrument issued under Paragraph 8(a) and all accrued interest, the instrument shall be returned to the Fund for cancellation. If less than the amount of any such instrument is repaid, the instrument shall be returned to the Fund and a new instrument for the remainder of the amount shall be substituted with the same maturity date as in the old instrument.

Paragraph 9. Interest

(a) The Fund shall pay interest on its indebtedness at a rate equal to the combined market interest rate computed by the Fund from time to time for the purpose of determining the rate at which it pays interest on holdings of special drawing rights. A change in the method of calculating the combined market interest rate shall apply only if the Fund and at least two thirds of the participants having three fifths of the total amount of the credit arrangements so agree; provided that if a participant so requests at the time this agreement is reached, the change shall not apply to the Fund's indebtedness to that participant outstanding at the date the change becomes effective.

(b) Interest shall accrue daily and shall be paid as soon as possible after each July 31, October 31, January 31, and April 30.

(c) Interest due to a participant shall be paid, as determined by the Fund, in special drawing rights, or in the participant's currency, or in other currencies that are actually convertible.

Paragraph 10. Use of Borrowed Currency

The Fund's policies and practices under Article V, Sections 3 and 7 on the use of its general resources and stand-by and extended arrangements, including those relating to the period of use, shall apply to purchases of currency borrowed by the Fund. Nothing in this Decision shall affect the authority of the Fund with respect to requests for the use of its resources by individual members, and access to these resources by members shall be determined by the Fund's policies and practices, and shall not depend on whether the Fund can borrow under this Decision.

Paragraph 11. Repayment by the Fund

(a) Subject to the other provisions of this Paragraph 11, the Fund, five years after a transfer by a participant, shall repay the participant an amount equivalent to the transfer calculated in accordance with Paragraph 12. If the drawer for whose purchase participants make transfers is committed to repurchase at a fixed date earlier than five years after its purchase, the Fund shall repay the participants at that date. Repayment under this Paragraph 11(a) or under Paragraph 11(c) shall be, as determined by the Fund, in the participant's currency whenever feasible, or in special drawing rights, or, after consultation

with the participant, in other currencies that are actually convertible. Repayments to a participant under Paragraph 11(b) and (e) shall be credited against transfers by the participant for a drawer's purchases in the order in which repayment must be made under this Paragraph 11(a).

(b) Before the date prescribed in Paragraph 11(a), the Fund, after consultation with a participant, may make repayment to the participant in part or in full. The Fund shall have the option to make repayment under this Paragraph 11(b) in the participant's currency, or in special drawing rights in an amount that does not increase the participant's holdings of special drawing rights above the limit under Article XIX, Section 4, of the Articles of Agreement unless the participant agrees to accept special drawing rights above that limit in such repayment, or, with the agreement of the participant, in other currencies that are actually convertible.

(c) Whenever a reduction in the Fund's holdings of a drawer's currency is attributed to a purchase of borrowed currency, the Fund shall promptly repay an equivalent amount. If the Fund is indebted to a participant as a result of transfers to finance a reserve tranche purchase by a drawer and the Fund's holdings of the drawer's currency that are not subject to repurchase are reduced as a result of net sales of that currency during a quarterly period covered by an operational budget, the Fund shall repay at the beginning of the next quarterly period an amount equivalent to that reduction, up to the amount of the indebtedness to the participant.

(d) Repayment under Paragraph 11(c) shall be made in proportion to the Fund's indebtedness to the participants that made transfers in respect of which repayment is being made.

(e) Before the date prescribed in Paragraph 11(a) a participant may give notice representing that there is a balance of payments need for repayment of part or all of the Fund's indebtedness and requesting such repayment. The Fund shall give the overwhelming benefit of any doubt to the participant's representation. Repayment shall be made after consultation with the participant in the currencies of other members that are actually convertible, or made in special drawing rights, as determined by the Fund. If the Fund's holdings of currencies in which repayment should be made are not wholly adequate, individual participants shall be requested, and will be expected, to provide the necessary balance under their credit arrangements. If, notwithstanding the expectation that the participants will provide the necessary balance, they fail to do so, repayment shall be made to the extent necessary in the currency of the drawer for whose purchases the participant requesting repayment made transfers. For all of the purposes of this Paragraph 11 transfers under this Paragraph 11(e) shall be deemed to have been made at the same time and for the same purchases as the transfers by the participant obtaining repayment under this Paragraph 11(e).

(f) All repayments to a participant in a currency other than its own shall be guided, to the maximum extent practicable, by the present and prospective balance of payments and reserve position of the members whose currencies are to be used in repayment.

(g) The Fund shall at no time reduce its holdings of a drawer's currency below an amount equal to the Fund's indebtedness to the participants resulting from transfers for the drawer's purchases.

(h) When any repayment is made to a participant, the amount that can be called for under its credit arrangement in accordance with this Decision shall be restored pro tanto.

(i) The Fund shall be deemed to have discharged its obligations to a participating institution to make repayment in accordance with the

provisions of this Paragraph or to pay interest in accordance with the provisions of Paragraph 9 if the Fund transfers an equivalent amount in special drawing rights to the member in which the institution is established.

Paragraph 12. Rates of Exchange

(a) The value of any transfer shall be calculated as of the date of the dispatch of the instructions for the transfer. The calculation shall be made in terms of the special drawing right in accordance with Article XIX, Section 7(a) of the Articles, and the Fund shall be obliged to repay an equivalent value.

(b) For all of the purposes of this Decision, the value of a currency in terms of the special drawing right shall be calculated by the Fund in accordance with Rule O-2 of the Fund's Rules and Regulations.

Paragraph 13. Transferability

A participant may not transfer all or part of its claim to repayment under a credit arrangement except with the prior consent of the Fund and on such terms and conditions as the Fund may approve.

Paragraph 14. Notices

Notice to or by a participating member under this Decision shall be in writing or by rapid means of communication and shall be given to or by the fiscal agency of the participating member designated in accordance with Article V, Section 1 of the Articles and Rule C-1 of the Rules and Regulations of the Fund. Notice to or by a participating institution shall be in writing or by rapid means of communication and shall be given to or by the participating institution.

Paragraph 15. Amendment

This Decision may be amended during the period prescribed in Paragraph 19(a) only by a decision of the Fund and with the concurrence of all participants. Such concurrence shall not be necessary for the modification of the Decision on its renewal pursuant to Paragraph 19(b).

Paragraph 16. Withdrawal of Adherence

A participant may withdraw its adherence to this Decision in accordance with Paragraph 19(b) but may not withdraw within the period prescribed in Paragraph 19(a) except with the agreement of the Fund and all participants.

Paragraph 17. Withdrawal from Membership

If a participating member or a member whose institution is a participant withdraws from membership in the Fund, the participant's credit arrangement shall cease at the same time as the withdrawal takes effect. The Fund's indebtedness under the credit arrangement shall be treated as an amount due from the Fund for the purpose of Article XXVI, Section 3, and Schedule J of the Articles.

Paragraph 18. Suspension of Exchange Transactions and Liquidation

(a) The right of the Fund to make calls under Paragraph 7 and the obligation to make repayments under Paragraph 11 shall be suspended during any suspension of exchange transactions under Article XXVII of the Articles.

(b) In the event of liquidation of the Fund, credit arrangements shall cease and the Fund's indebtedness shall constitute liabilities under Schedule K of the Articles. For the purpose of Paragraph 1(a) of Schedule K, the currency in which the liability of the Fund shall be payable shall be first the participant's currency and then the currency of the drawer for whose purchases transfers were made by the participants.

Paragraph 19. Period and Renewal

(a) This Decision shall continue in existence for four years from its effective date. A new period of five years shall begin on the effective date of Decision No. 7337-(83/37), adopted February 24, 1983. References in Paragraph 19(b) to the period prescribed in Paragraph 19(a) shall refer to this new period and to any subsequent renewal periods that may be decided pursuant to Paragraph 19(b). When considering a renewal of this Decision for the period following the five-year period referred to in this Paragraph 19(a), the Fund and the participants shall review the functioning of this Decision, including the provisions of Paragraph 21.

(b) This Decision may be renewed for such period or periods and with such modifications, subject to Paragraph 5, as the Fund may decide. The Fund shall adopt a decision on renewal and modification, if any, not later than twelve months before the end of the period prescribed in Paragraph 19(a). Any participant may advise the Fund not less than six months before the end of the period prescribed in Paragraph 19(a) that it will withdraw its adherence to the Decision as renewed. In the absence of such notice, a participant shall be deemed to continue to adhere to the Decision as renewed. Withdrawal of adherence in accordance with this Paragraph 19(b) by a participant, whether or not included in the Annex, shall not preclude its subsequent adherence in accordance with Paragraph 3(b).

(c) If this Decision is terminated or not renewed, Paragraph 8 through 14, 17 and 18(b) shall nevertheless continue to apply in connection with any indebtedness of the Fund under credit arrangements in existence at the date of the termination or expiration of the Decision until repayment is completed. If a participant withdraws its adherence to this Decision in accordance with Paragraph 16 or Paragraph 19(b), it shall cease to be a participant under the Decision, but Paragraphs 8 through 14, 17 and 18(b) of the Decision as of the date of the withdrawal shall nevertheless continue to apply to any indebtedness of the Fund under the former credit arrangement until repayment has been completed.

Paragraph 20. Interpretation

Any question of interpretation raised in connection with this Decision which does not fall within the purview of Article XXIX of the Articles shall be settled to the mutual satisfaction of the Fund, the participant raising the question, and all other participants. For the purpose of this Paragraph 20 participants shall be deemed to include those former participants to which Paragraphs 8 through 14, 17 and 18(b) continue to apply pursuant to Paragraph 19(c) to the extent that any such former participant is affected by a question of interpretation that is raised.

Paragraph 21. Use of Credit Arrangements for Nonparticipants

(a) The Fund may make calls in accordance with Paragraphs 6 and 7 for exchange transactions requested by members that are not participants if the exchange transactions are (i) transactions in the upper credit tranches, (ii) transactions under stand-by arrangements extending beyond the first credit tranche, (iii) transactions under extended arrangements, or (iv) transactions in the first credit tranche in conjunction with a stand-by or an extended arrangement. All the provisions of this Decision relating to calls shall apply, except as otherwise provided in Paragraph 21(b).

(b) The Managing Director may initiate the procedure for making calls under Paragraph 7 in connection with requests referred to in Paragraph 21(a) if, after consultation, he considers that the Fund faces an inadequacy of resources to meet actual and expected requests for financing that reflect the existence of an exceptional situation associated with balance of payments problems of members of a character or aggregate size that could threaten the stability of the international monetary system. In making proposals for calls pursuant to Paragraph 21(a) and (b), the Managing Director shall pay due regard to potential calls pursuant to other provisions of this Decision.

Paragraph 22. Participation of the Swiss National Bank

(a) Notwithstanding any other provision of this Decision, the Swiss National Bank (hereinafter called the Bank) may become a participant by adhering to this Decision in accordance with Paragraph 3(c) and accepting, by its adherence, a credit arrangement in an amount equivalent to one thousand and twenty million special drawing rights. Upon adherence, the Bank shall be deemed to be a participating institution, and all the provisions of this Decision relating to participating institutions shall apply in respect of the Bank, subject to, and as supplemented by, Paragraph 22(b), (c), (d), (e), and (f).

(b) Under its credit arrangement, the Bank undertakes to lend any currency, specified by the Managing Director after consultation with the Bank at the time of a call, that the Fund has determined to be a freely usable currency pursuant to Article XXX(f) of the Articles.

(c) In relation to the Bank, the references to the balance of payments and reserve position in Paragraph 7(b) and (d), and Paragraph 11(e), shall be understood to refer to the position of the Swiss Confederation.

(d) In relation to the Bank, the references to a participant's currency in Paragraph 9(c), Paragraph 11(a) and (b), and Paragraph 18(b) shall be understood to refer to any currency, specified by the Managing Director after consultation with the Bank at the time of payment by the Fund, that the Fund has determined to be a freely usable currency pursuant to Article XXX(f) of the Articles.

(e) Payment of special drawing rights to the Bank pursuant to Paragraph 9(c) and Paragraph 11 shall be made only while the Bank is a prescribed holder pursuant to Article XVII of the Articles.

(f) The Bank shall accept as binding a decision of the Fund on any question of interpretation raised in connection with this Decision which falls within the purview of Article XXIX of the Articles, to the same extent as that decision is binding on other participants.

Paragraph 23. Associated Borrowing Arrangements

(a) A borrowing arrangement between the Fund and a member that

is not a participant, or an official institution of such a member, under which the member or the official institution undertakes to make loans to the Fund for the same purposes as, and on terms comparable to, those made by participants under this Decision, may, with the concurrence of all participants, authorize the Fund to make calls on participants in accordance with Paragraphs 6 and 7 for exchange transactions with that member, or to make requests under Paragraph 11(e) in connection with an early repayment of a claim under the borrowing arrangement, or both. For the purposes of this Decision such calls or requests shall be treated as if they were calls or requests in respect of a participant.

(b) Nothing in this Decision shall preclude the Fund from entering into any other types of borrowing arrangements, including an arrangement between the Fund and a lender, involving an association with participants, that does not contain the authorizations referred to in Paragraph 23(a).

ANNEX

Participants and Amounts of Credit Arrangements

I. Prior to the Effective Date of Decision No. 7337-(83/37)

Participant		Amount in Units of Participant's currency
1. United States of America	US\$	2,000,000,000
2. Deutsche Bundesbank	DM	4,000,000,000
3. United Kingdom	£	357,142,857
4. France	F	2,715,381,428
5. Italy	Lit	343,750,000,000
6. Japan	Yen	340,000,000,000
7. Canada	Can\$	216,216,000
8. Netherlands	f.	724,000,000
9. Belgium	BF	7,500,000,000
10. Sveriges Riksbank	SKr	517,320,000

II. From the Effective Date of Decision No. 7337-(83/37)

Participant	Amount in special drawing rights
1. United States of America	4,250,000,000
2. Deutsche Bundesbank	2,380,000,000
3. Japan	2,125,000,000
4. France	1,700,000,000
5. United Kingdom	1,700,000,000
6. Italy	1,105,000,000
7. Canada	892,500,000
8. Netherlands	850,000,000
9. Belgium	595,000,000
10. Sveriges Riksbank	382,500,000
11. Swiss National Bank*	1,020,000,000
	<u>17,000,000,000</u>

*With effect from the date on which the Swiss National Bank adheres to this Decision in accordance with Paragraph 22.

IMF Drawings by the United States

The United States has drawn on the International Monetary Fund (IMF) on twenty-four occasions over the past 19 years for a total of about SDR 5.8 billion (equivalent to about \$6.5 billion at the exchange rates prevailing at the time of each drawing), the second largest amount of cumulative drawings of any IMF member. None of these drawings was subject to IMF policy conditionality, as they all involved drawings on the U.S. reserve position in the IMF. Drawings on the reserve position are available automatically upon representation of balance of payments need; do not bear interest and are not subject to repurchase obligations; and do not involve policy conditionality.

The U.S. drawings were for the following purposes: during the 1960s and early 1970s they were designed to limit foreign purchases of U.S. gold reserves; subsequently, they were designed to provide the United States with foreign currencies for the purpose of exchange market operations. These purposes are explained below. A table listing all U.S. drawings is attached.

Drawings During the 1960s and 1970s

Under the international monetary arrangements in operation following World War II, each member of the IMF was required to establish and maintain a "par value" for its currency in terms of gold. The United States undertook to fulfill its par value obligations by standing ready to convert dollars held by foreign monetary authorities into gold at the official price of \$35 per ounce -- i.e., the par value of the dollar. Other countries met their par value obligations by maintaining exchange rates for their currencies -- directly or indirectly -- in terms of the dollar within narrow margins. In this manner, a structure of currency exchange rates linked to gold was established and maintained.

During the 1950s and 1960s, large payments imbalances, substantial losses of U.S. gold and foreign accumulations of dollar holdings, representing further potential strains on U.S. gold, put increasing strain on this system. Beginning in the early 1960s the United States, in cooperation with foreign monetary authorities, initiated a variety of measures designed to limit pressures on U.S. gold holdings. U.S. drawings on the IMF were an integral part of this program.

In general, IMF drawings provided the United States with foreign currencies that could be used to purchase dollars from foreign monetary authorities and thus reduce demands for conversion of official dollar holdings to gold. The foreign currencies obtained from the IMF were used most often in the following types of transactions:

- to facilitate repayment of IMF drawings by other countries without necessitating the use of U.S. gold;
- repayment of U.S. short-term currency swaps with foreign central banks; and

- direct purchases by the United States of foreign official dollar holdings that would otherwise be used to purchase U.S. gold.

Drawings Since the Early 1970s

With the end of the par value/gold convertibility arrangements in the early 1970s, the basic purpose of U.S. drawings from the IMF was to finance U.S. intervention in the exchange markets in support of the dollar. During the 1970s, the U.S. intervened directly in the foreign exchange market, buying and selling foreign currencies for dollars, in order to deal with exchange market pressures on the dollar. The foreign currencies obtained from U.S. drawings in the IMF provided an important source of funds for such intervention. In November 1978, a U.S. drawing of \$3 billion of German marks and Japanese yen was a component of a major program of U.S. and foreign intervention in the exchange market to support the dollar.

IMF Drawings by the United States

The United States has drawn on the International Monetary Fund (IMF) on twenty-four occasions over the past 19 years for a total of about SDR 5.8 billion (equivalent to about \$6.5 billion at the exchange rates prevailing at the time of each drawing), the second largest amount of cumulative drawings of any IMF member. None of these drawings was subject to IMF policy conditionality, as they all involved drawings on the U.S. reserve position in the IMF. Drawings on the reserve position are available automatically upon representation of balance of payments need; do not bear interest and are not subject to repurchase obligations; and do not involve policy conditionality.

The U.S. drawings were for the following purposes: during the 1960s and early 1970s they were designed to limit foreign purchases of U.S. gold reserves; subsequently, they were designed to provide the United States with foreign currencies for the purpose of exchange market operations. These purposes are explained below. A table listing all U.S. drawings is attached.

Drawings During the 1960s and 1970s

Under the international monetary arrangements in operation following World War II, each member of the IMF was required to establish and maintain a "par value" for its currency in terms of gold. The United States undertook to fulfill its par value obligations by standing ready to convert dollars held by foreign monetary authorities into gold at the official price of \$35 per ounce -- i.e., the par value of the dollar. Other countries met their par value obligations by maintaining exchange rates for their currencies -- directly or indirectly -- in terms of the dollar within narrow margins. In this manner, a structure of currency exchange rates linked to gold was established and maintained.

During the 1950s and 1960s, large payments imbalances, substantial losses of U.S. gold and foreign accumulations of dollar holdings, representing further potential strains on U.S. gold, put increasing strain on this system. Beginning in the early 1960s the United States, in cooperation with

foreign monetary authorities, initiated a variety of measures designed to limit pressures on U.S. gold holdings. U.S. drawings on the IMF were an integral part of this program.

In general, IMF drawings provided the United States with foreign currencies that could be used to purchase dollars from foreign monetary authorities and thus reduce demands for conversion of official dollar holdings to gold. The foreign currencies obtained from the IMF were used most often in the following types of transactions:

IMF Drawings by the United States
(SDR Millions)

<u>Date</u>	<u>Amount</u>	<u>Date</u>	<u>Amount</u>
1964: Feb	125	1968: March	200
June	125	Total	200
Sept	150	1970: May	150
Dec	125	Total	150
Total	525	1971: Jan	250
1965 March	75	June	250
July	300	Aug	862
Sept	60	Total	1,362
Total	435	1972: April	200
1966 Jan	100	Total	200
March	60	1978: Nov	2,275
April	30	Total	2,275
May	30		
July	71		
Aug	282		
Sept	35		
Oct	31		
Nov	12		
Dec	30		
Total	681	Grand Total	5,828 ^{1/}

^{1/} Equivalent to about \$6.5 billion at exchange rates prevailing at the time of each drawing.

Budgetary and Financing Impact
of Transactions with the IMF under
the U.S. Quota in the IMF
and U.S. Loans to the IMF

Under budget and accounting procedures established in consultation with the Congress at the time of the 1980 increase in the U.S. IMF quota, an increase in the U.S. quota or line of credit to the IMF requires budget authorization and appropriation for the full amount of increases in the quota or U.S. lending arrangements. The sum is included in the budget authority totals for the fiscal year requested. Payment to the IMF of the increased quota subscription is made partly (25 percent) in reserve assets (SDRs or foreign currencies) and partly in non-interest bearing letters of credit, which are a contingent liability. Under the credit lines established pursuant to IMF borrowing arrangements with the United States, the Treasury is committed to provide funds upon call by the IMF.

A budget expenditure occurs only as cash is actually transferred to the IMF, through the 25 percent reserve asset payment, through encashment of the quota letter of credit, or against the borrowing arrangements. Simultaneous with such transfers, the U.S. receives an equal offsetting receipt, representing an increase in the U.S. reserve position in the IMF -- an interest-bearing, liquid international monetary asset that is available unconditionally to the United States in case of balance of payments need. As a consequence of these offsetting transactions, transfers to the IMF under the quota subscription or U.S. lending arrangements therefore do not result in net budget outlays, or directly affect the budget deficit. Similarly, payments of dollars by the IMF to the United States (for example, resulting from repayments by other IMF member countries) do not result in net budget receipts since the U.S. reserve position declines simultaneously by a like amount.

Transfers from the United States to the IMF under the U.S. quota or U.S. lending arrangements increase Treasury borrowing requirements, while transfers from the IMF to the United States improve the Treasury's cash position and reduce its borrowing requirement. The net effect of transfers to and from the IMF has varied widely over the years, resulting in cash outflows from the Treasury in some years and inflows to the Treasury in other years. Moreover, Treasury interest costs on borrowings to finance any net transfers to the IMF need to be balanced against the remuneration (interest) earned on the U.S. reserve position in the IMF. Finally, the U.S. may incur exchange gains and losses on the U.S. reserve position in the IMF due to changes in the dollar value of the SDR.

It is not possible to project the effect on Treasury borrowing requirements or the net cost of U.S. transactions with the IMF because of uncertainties regarding the future level of IMF financing; the portion of such financing that would be in dollars; and movements in market interest and exchange rates. However, the figures in the attached table indicate that for the period from July 1, 1969, to the end of 1982:

- Net increases in Treasury borrowing requirements attributable to transactions with the IMF averaged

\$498 million annually, compared to average annual increases in Treasury borrowing of \$61 billion.

- Treasury debt outstanding attributable to transactions with the IMF averaged \$1.9 billion annually. This is not an annual increase in Treasury borrowing, but an estimate of the average total debt outstanding each year attributable to cumulative U.S. transactions with the IMF. During fiscal 1982, the average outstanding Treasury borrowing attributable to such transactions amounted to \$5.3 billion, about 1/2 of 1 percent of the total outstanding Treasury debt of \$1.1 trillion at the end of the fiscal year.
- Net interest costs to the Treasury associated with all U.S. transactions with the IMF averaged \$45 million annually. In fiscal 1982, interest costs on total Treasury debt amounted to \$117 billion.
- Net annual valuation losses to the U.S. on the U.S. reserve position in the IMF averaged \$62 million.
- The overall net annual cost to the U.S., taking account of interest and valuation, thus averaged \$107 million.

Revised to U.S.
Fiscal Year Basis
March 4, 1983

TABLE 1
Estimated Public Debt, Servicing Costs and Budgetary Effects Associated With U.S. Transactions
Under U.S. Quota and U.S. Loans to IMF, FY 1970-1983¹
(millions of dollars)

During U.S. Fiscal Year	Average Outstanding Net Treasury Debt(-) or Cash(+) Position Arising From		Est. Treasury Borrowing Cost(-) or Reduction(+) from		Interest Received on Loans by U.S.		Remuneration Received by U.S. from IMF		Valuation Gain(+) Losses(-) on U.S. Reserve Position		Interest Earned on Holdings of Foreign Cur- rencies Drawn from IMF		Total Estimated Net Budgetary Receipts(+) or Outlays(-) 9/ (9)
	1/ Quota	2/ IMF	3/ Total	4/ Column(3)	5/ to IMF	6/ from IMF	7/ Position	8/ from IMF	9/ Position	10/ from IMF	11/ from IMF	12/ from IMF	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1970	-860	-	-860	-66	-	+13	-	-	-	-	-	-	-53
1971	-571	-	-571	-28	-	+12	-	-	-	-	-	-	-16
1972	+631	-	+631	+26	-	+	+34	-	-	-	-	-	+60
1973	+801	-	+801	+42	-	-	-	-	-	-	-	-	+42
1974	+627	-	+627	+50	-	-	-	-	-	-	-	-	+104
1975	-481	-	-481	-32	-	+	+40	-	-	-	-	-	+16
1976	-1,131	-	-1,131	-63	-	+9	-168	-	-	-	-	-	-222
TO	-2,467	-	-2,467	-32	-	-	+39	-	-	-	-	-	+7
1977	-2,973	-379	-3,352	-164	+14	+79	+27	-	-	-	-	-	-44
1978	-2,314	-663	-2,977	-196	+31	+80	+369	-	-	-	-	-	+204
1979	-834	-64	-898	-83	+12	+27	+212	+48	-	-	-	-	+216
1980	-609	-94	-703	-76	+	-	-13	+40	-	-	-	-	-51
1981	-2,183	-559	-2,742	-376	+46	+22	-1,295	+69	-	-	-	-	-1,534
1982	-4,733	-1,036	-5,769	-619	+122	+216	-323	+76	-	-	-	-	-528
1983 ¹	-5,464	-1,308	-6,772	-134	-	+222	+173	+15	-	-	-	-	+276
Total Periods 7/1/69-12/31/82	-1,634	-304	-1,938	-1,753	+225	+680	-843	+248	-	-	-	-	-1,443
Annual Average				-130	+17	+50	-62	+18	-	-	-	-	-107

Footnotes to Table 1

*Indicates less than \$500,000.

- 1/ Estimate of average outstanding Treasury debt or cash position during period arising from U.S. transfers of dollars to the IMF (i.e., an outflow of dollars from Treasury) and dollar balances received by the U.S. from the IMF and from sales of foreign currency drawn by the U.S. from the IMF (i.e., an inflow of dollars to the Treasury).
- 2/ Estimate of average outstanding Treasury debt during period arising from U.S. loans and repayments under the IMF's General Arrangements to Borrow and Supplementary Financing Facility.
- 3/ Sum of columns 1 and 2. Transfers to and from the IMF under the U.S. quota subscription or U.S. lending arrangements result in budget outlays and simultaneous receipts of U.S. reserve position in the IMF; these transactions have a zero effect on net outlays and the budget deficit.
- 4/ Estimate of interest paid or borrowing reduced during period as result of cumulative debt or cash position arising from U.S. transactions with IMF; equals column 3 times average Treasury 3-month bill rate during period. Payments enter the U.S. budget as interest on the public debt; inflows reduce Treasury's need to borrow and thus reduce interest expense.
- 5/ Enters the U.S. budget as a receipt.
- 6/ Remuneration on U.S. creditor positions; prior to 1975, remuneration was 1.5 percent, although special income distributions were made in 1970 and 1971 which raised the effective rate to 2.0 percent in those years. From 1975, the rate was based on short-term market interest rates in the five largest IMF members (U.S., U.K., Germany, France, Japan). Enters the U.S. budget as a receipt. Payments are made by IMF annually, as of April 30.
- 7/ Reflects changes in the dollar value of the U.S. reserve position in the IMF due to an appreciation (-) or depreciation (+) of the dollar in terms of the SDR. Enters the U.S. budget as a positive or negative net outlay.
- 8/ Interest earned on investments of German marks and Japanese yen acquired from U.S. drawing on IMF in November 1978. Enters the U.S. budget as part of the net profit or loss of the Exchange Stabilization Fund of the Treasury, recorded as a positive or negative net outlay.
- 9/ Equal to the sum of columns 4 through 8.
- 10/ Remuneration accrued May-December 1982, following receipt of remuneration for IMF fiscal year ending April 1982.

TABLE 2

Estimated Annual Treasury Public Borrowing Requirements
and Financing Costs Related to U.S. Transactions Under U.S. Quota
and U.S. Loans to IMF, FY 1970-1983I
(millions of dollars)

During U.S. Fiscal Year	Dollar Funds Supplied(-) or Received(+) by Treasury During Period, Arising From:			Estimated Treasury Borrowing Cost(-) or Reduction(+) Arising from Debt or Cash Position Related to IMF Transactions 4/
	Transactions Under U.S. Quota	U.S. Loans to IMF 2/	Total 3/	
1970	-802	-	-802	-66
1971	+908	-	+908	-28
1972	+986	-	+986	+26
1973	-50	-	-50	+42
1974	-471	-	-471	+50
1975	-1,073	-	-1,073	-32
1976	-1,205	-	-1,205	-63
TQ	-702	-	-702	-32
1977	-105	-662	-767	-164
1978	+963	+39	+1,002	-196
1979	+1,333	+633	+1,966	-83
1980	-412	-303	-715	-78
1981	-2,359	-537	-2,896	-376
1982	-1,826	-345	-2,171	-619
1983I	-572	-160	-732	-134
<u>Total Net Change:</u> 7/1/69-12/31/82	-5,387	-1,335	-6,722	-1,753
<u>Annual Average</u> <u>Change:</u>	-399	-99	-498	-130

Footnotes to Table 2

- 1/ U.S. transfers of dollars to the IMF (i.e., an outflow of dollars from Treasury) and dollar balances received by the U.S. from the IMF and from sales of foreign currency drawn by the U.S. from the IMF (i.e., an inflow of dollars to the Treasury).
- 2/ U.S. loans and repayments under the IMF's General Arrangements to Borrow and Supplementary Financing Facility; includes interest received in dollars by the U.S.
- 3/ Total net dollar funds supplied or received by Treasury annually; indicates impact on Treasury public borrowing requirements.
- 4/ Estimated cost of servicing annual average of outstanding public debt associated with transactions under U.S. quota and on U.S. loans to IMF; from Table 1.

APPENDIX A

INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 83/17

FOR IMMEDIATE RELEASE
March 1, 1983

The Executive Board of the International Monetary Fund has taken two actions which, when they become effective, will substantially increase the Fund's ability to extend balance of payments assistance to its member countries.

Under the first action, the Executive Board has submitted a resolution to the Board of Governors containing proposals for increases in members' quotas under the Eighth General Review of Quotas in the Fund. If all members accept the increases in their quotas to the proposed amounts, total quotas in the Fund would rise to approximately SDR 90 billion from SDR 61 billion.

Under the second action, the Executive Board has adopted a decision approving a revision and an enlargement of the General Arrangements to Borrow (GAB), which, when it becomes effective, will, inter alia, increase the amount of resources available to the Fund under the GAB from approximately SDR 6.4 billion to SDR 17 billion, and make GAB resources available to finance purchases by any Fund member.

Attached are two separate press releases (Nos. 83/18 and 83/19) containing additional information on the proposals for the Eighth General Review of Quotas and the decision on the General Arrangements to Borrow.

PRESS RELEASE NO. 83/18

FOR IMMEDIATE RELEASE
March 1, 1983

The Executive Board of the International Monetary Fund has submitted a Resolution to the Board of Governors proposing an increase in Fund quotas to approximately SDR 90 billion from SDR 61 billion.

The Governors are to vote on the proposed Resolution, without meeting, by March 31, 1983. The adoption of the Resolution requires a majority of 85 per cent of the total voting power of the Fund's membership.

The Resolution is accompanied by a report of the Executive Board on matters relating to the Eighth General Review of Quotas, and follows agreements reached by the Interim Committee at its meeting on February 10-11, 1983 in Washington, D.C. Annexed to the Resolution are the quotas proposed for each member which were arrived at in the following way:

Forty per cent of the overall increase was distributed to all members in proportion to their present individual quotas, and the balance of 60 per cent was distributed in the form of selective adjustments in proportion to each member's share in the total of the calculated quotas, i.e., the quotas that broadly reflect members' relative positions in the world economy.

Twenty-five per cent of the increase in each member's quota will be paid in SDRs, or in currencies of other members prescribed by the Fund, subject to their concurrence.

The Executive Board also considered the position of the 17 members with very small quotas, i.e., those quotas that are currently less than

SDR 10 million. As noted in its report to the Board of Governors, the Executive Board recommends that the quotas of these 17 members shall, after being increased by the method applicable uniformly to all members, be further adjusted to the next higher multiple of SDR 0.5 million. All other quotas would be rounded to the next higher multiple of SDR 0.1 million.

Under the Resolution, members would have until November 30, 1983 to consent to the proposed increases. In order to meet this date members will need to expedite whatever action may be necessary under their laws to enable them to give their consent to the quotas proposed for them. A member's quota cannot be increased until it has consented to the increase and paid the subscription in full. No increase in quota becomes effective before the date of the Fund's determination that members having not less than 70 per cent of present quotas have consented to the increases proposed for them.

The report of the Executive Board to the Board of Governors on the increase in quotas of Fund members under the Eighth General Review, and the Resolution as sent to the Board of Governors with the Annex showing the proposed quotas for all members, are attached.

ATTACHMENT I

: INTERNATIONAL MONETARY FUND

Report of the Executive Directors to the Board of Governors: Increase in Quotas of Fund Members - Eighth General Review

1. Article III, Section 2(a) of the Articles of Agreement provides that "The Board of Governors shall at intervals of not more than five years conduct a general review, and if it deems it appropriate, propose an adjustment of the quotas of the members. It may also, if it thinks fit, consider at any other time the adjustment of any particular quota at the request of the member concerned." This report and the attached Resolution on increases in quotas under the current, i.e., Eighth, General Review are submitted to the Board of Governors in accordance with Article III, Section 2.
2. The Seventh General Review of Quotas was completed by Board of Governors Resolution No. 34-2, adopted December 11, 1978. To comply with the five-year interval prescribed by Article III, Section 2(a), the Eighth General Review has to be completed not later than December 11, 1983. In the Report of the Executive Board to the Board of Governors on Increases in Quotas of Fund Members—Seventh General Review, it was stated that:

"The Executive Board will review the customary method of calculating quotas after the Seventh Review of Quotas has been completed. In the context of the next general review of quotas, the Executive Board will examine the quota shares of members in relation to their positions in the world economy with a view to adjusting those shares better to reflect members' relative economic positions while having regard to the desirability of an appropriate balance in the composition of the Executive Board."
3. At its meeting in Helsinki, Finland, in May 1982, the Interim

Committee urged the Executive Board to pursue its work on the Eighth General Review as a matter of high priority. At that meeting the Committee also "... noting that the present quotas of a significant number of members do not reflect their relative positions in the world economy, ... reaffirmed its view that the occasion of an enlargement of the Fund under the Eighth General Review should be used to bring the quotas of these members more in line with their relative positions, taking account of the case for maintaining a proper balance between the different groups of countries." At its meeting in Toronto, Canada, in September 1982, the Committee noted that "there was widespread support in the Committee on the urgent need for a substantial increase in quotas under the Eighth General Review" and "urged the Executive Board to pursue its work on the issues of the Review as a matter of high priority, so that the remaining issues on the size and distribution of the quota increase could be resolved by the time of the Committee's next meeting in April 1983."

4. In its discussions on the Eighth General Review, the Executive Board has considered, inter alia, (i) the method of calculating quotas; (ii) the size of the overall increase in quotas; (iii) the distribution of the overall increase; (iv) the position of countries with very small quotas in the Fund; and (v) the mode of payment for the increase in quotas.

5. As regards the Executive Board's review of the method of calculating quotas, the Executive Board agreed to certain changes regarding the quota formulas used for calculating quotas in connection with the Eighth General Review. The Executive Board accepted the quota calculations based on the revised quota formulas as reasonable indicators of the relative positions of countries in the world economy, though some Directors felt that they do not provide a wholly satisfactory measure of relative economic positions. It is understood that the changes that have been made do not preclude further appropriate changes in connection with future reviews.

6. At the meeting of the Interim Committee held in Washington in February 1983, which had been advanced from April 1983, agreement was reached on all major issues of the Eighth Review, as reflected in the relevant passages from the Committee's communique of February 11, 1983, as follows:

"(a) The total of Fund quotas should be increased under the Eighth General Review from approximately SDR 61.03 billion to SDR 90 billion (equivalent to about US\$98.5 billion).

(b) Forty per cent of the overall increase should be distributed to all members in proportion to their present individual quotas, and the balance of sixty per cent should be distributed in the form of selective adjustments in proportion to each member's share in the total of the calculated quotas, i.e., the quotas that broadly reflect members' relative positions in the world economy.

(c) Twenty-five per cent of the increase in each member's quota should be paid in SDRs or in usable currencies of other members."

The Committee also considered the possibility of a special adjustment of very small quotas, i.e., those quotas that are currently less than SDR 10 million, and agreed to refer this matter to the Executive Board for urgent consideration in connection with the implementation of the main decision.

7. As requested by the Interim Committee at its meeting on February 11,

1983, the Executive Board has considered the position of the 17 members with very small quotas—i.e., those with quotas that at present are less than SDR 10 million. The Executive Board proposes that the quotas of these members should, after being increased in accordance with (b) quoted in paragraph 6 above, be further adjusted to the next higher multiple of SDR 0.5 million. The Executive Board proposes that all other quotas be rounded to the next higher multiple of SDR 0.1 million. The rounding to SDR 0.5 million would provide for larger quota increases relative to present quotas for most of the members with very small quotas.

8. In accordance with the agreement reached by the Interim Committee at its meeting on February 11, 1983, on items (a) and (b) quoted in paragraph 6 above and with rounding adjustments indicated in paragraph 7 above, the Executive Board proposes to the Board of Governors that the new quotas of members be as set out in the Annex to the proposed Resolution. These increases would raise Fund quotas from approximately SDR 61 billion to approximately SDR 90 billion.

9. Article III, Section 3(a) provides that 25 per cent of any increase shall be paid in special drawing rights, but permits the Board of Governors to prescribe, *inter alia*, that this payment may be made on the same basis for all members, in whole or in part in the currencies of other members specified by the Fund, subject to their concurrence. Paragraph 5 of the Resolution provides that 25 per cent of the increase in quotas proposed as a result of the current review should be paid in SDRs or in currencies of other members selected by the Fund, subject to their concurrence, or in any combination of SDRs and such currencies. The balance of the increase shall be paid in a member's own currency. A reserve asset payment will help strengthen the liquidity of the Fund and will not impose an undue burden on members because under the existing decisions of the Fund a reserve asset payment will either enlarge or create a reserve tranche position of an equivalent amount. In addition, the Fund stands ready to assist members that do not hold sufficient reserves to make their reserve asset payments to the Fund to borrow SDRs from other members willing to cooperate; these loans would be made on the condition that such members would repay on the same day the loans from the SDR proceeds of drawings of reserve tranches which had been established by the payment of SDRs.

10. Under the proposed Resolution, a member will be able to consent only to the amount of quota proposed for it in the Annex. A member will be able to consent to the increase in its quota at any time before 6:00 p.m., Washington time, November 30, 1983. In order to meet this time, members will have until the end of November 1983 to complete whatever action may be necessary under their laws to enable them to give their consents.

11. A member's quota cannot be increased until it has consented to the increase and paid the subscription. Under the proposed Resolution, the increase in a member's quota will take effect only after the Fund has received the member's consent to the increase in quota and a member has paid the increase in subscription, provided that the quota cannot become effective before the date on which the Fund determines that the participation requirement in paragraph 2 of the proposed Resolution has been satisfied. The Executive Board is authorized by paragraph 3 of the proposed Resolution to extend the period of consent.

12. The participation requirement in paragraph 2 will be reached when the Fund determines that members having not less than seventy per cent of the total of quotas on February 28, 1983 have consented to the increases in their respective quotas as set out in the Annex.

13. The proposed Resolution provides that a member must pay the increase in its subscription within 30 days after (a) the date on which the

member notifies the Fund of its consent, or (b) the date on which the participation requirement is met, whichever is the later.

14. The Executive Board recommends that the Board of Governors adopt the attached Resolution that covers all the matters on which the Governors are requested to act. The adoption of the Resolution requires positive responses from Governors having an 85 per cent majority of the total voting power.

ATTACHMENT II

Proposed Resolution of the Board of Governors: Increase in Quotas of Fund Members--Eighth General Review

WHEREAS the Executive Board has submitted to the Board of Governors a report entitled "Increases in Quotas of Fund Members--Eighth General Review" containing recommendations on increases in the quotas of individual members of the Fund; and

WHEREAS the Executive Board has recommended the adoption of the following Resolution of the Board of Governors, which Resolution proposes increases in the quotas of members of the Fund as a result of the Eighth General Review of Quotas and deals with certain related matters, by vote without meeting pursuant to Section 13 of the By-Laws of the Fund;

NOW, THEREFORE, the Board of Governors hereby RESOLVES that:

1. The International Monetary Fund proposes that, subject to the provisions of this Resolution, the quotas of members of the Fund shall be increased to the amounts shown against their names in the Annex to this Resolution.
2. A member's increase in quota as proposed by this Resolution shall not become effective unless the member has notified the Fund of its consent to the increase not later than the date prescribed by or under paragraph 3 below and has paid the increase in quota in full, provided that no increase in quota shall become effective before the date of the Fund's determination that members having not less than 70 per cent of the total of quotas on February 28, 1983 have consented to the increases in their quotas.
3. Notices in accordance with paragraph 2 above shall be executed by a duly authorized official of the member and must be received in the Fund before 6:00 p.m., Washington time, November 30, 1983, provided that the Executive Board may extend this period as it may determine.
4. Each member shall pay to the Fund the increase in its quota within 30 days after the later of (a) the date on which it notifies the Fund of its consent, or (b) the date of the Fund's determination under paragraph 2 above.
5. Each member shall pay twenty-five per cent of its increase either in special drawing rights or in the currencies of other members specified, with their concurrence, by the Fund, or in any combination of special drawing rights and such currencies. The balance of the increase shall be paid by the member in its own currency.

ANNEX

Proposed Quota
(In millions of SDRs)

1.	Afghanistan	86.7
2.	Algeria	623.1
3.	Antigua and Barbuda	5.0
4.	Argentina	1,113.0
5.	Australia	1,619.2
6.	Austria	775.6
7.	Bahamas	66.4
8.	Bahrain	48.9
9.	Bangladesh	287.5
10.	Barbados	34.1
11.	Belgium	2,080.4
12.	Belize	9.5
13.	Benin	31.3
14.	Bhutan	2.5
15.	Bolivia	90.7
16.	Botswana	22.1
17.	Brazil	1,461.3
18.	Burma	137.0
19.	Burundi	42.7
20.	Cameroon	92.7
21.	Canada	2,941.0
22.	Cape Verde	4.5
23.	Central African Republic	30.4
24.	Chad	30.6
25.	Chile	440.5
26.	China	2,390.9
27.	Colombia	394.2
28.	Comoros	4.5
29.	Congo, People's Republic	37.3
30.	Costa Rica	84.1
31.	Cyprus	69.7
32.	Denmark	711.0
33.	Djibouti	8.0
34.	Dominica	4.0
35.	Dominican Republic	112.1
36.	Ecuador	150.7
37.	Egypt	463.4
38.	El Salvador	89.0
39.	Equatorial Guinea	18.4
40.	Ethiopia	70.6

Proposed Quota
(In millions of SDRs)

41.	Fiji	36.5
42.	Finland	574.9
43.	France	4,482.8
44.	Gabon	73.1
45.	Gambia, The	17.1
46.	Germany	5,403.7
47.	Ghana	204.5
48.	Greece	399.9
49.	Grenada	6.0
50.	Guatemala	108.0
51.	Guinea	57.9
52.	Guinea-Bissau	7.5
53.	Guyana	49.2
54.	Haiti	44.1
55.	Honduras	67.8
56.	Hungary	530.7
57.	Iceland	59.6
58.	India	2,207.7
59.	Indonesia	1,009.7
60.	Iran, Islamic Republic of	1,117.4
61.	Iraq	504.0
62.	Ireland	343.4
63.	Israel	446.6
64.	Italy	2,909.1
65.	Ivory Coast	165.5
66.	Jamaica	145.5
67.	Japan	4,223.3
68.	Jordan	73.9
69.	Kampuchea, Democratic	25.0
70.	Kenya	142.0
71.	Korea	462.8
72.	Kuwait	635.3
73.	Lao People's Democratic Republic	29.3
74.	Lebanon	78.7
75.	Lesotho	15.1
76.	Liberia	71.3
77.	Libya	515.7
78.	Luxembourg	77.0
79.	Madagascar	66.4
80.	Malawi	37.2

Proposed Quota
(In millions of SDRs)

:	
81. Malaysia	550.6
82. Maldives	2.0
83. Mali	50.8
84. Malta	45.1
85. Mauritania	33.9
86. Mauritius	53.6
87. Mexico	1,165.5
88. Morocco	306.6
89. Nepal	37.3
90. Netherlands	2,264.8
91. New Zealand	461.6
92. Nicaragua	68.2
93. Niger	33.7
94. Nigeria	849.5
95. Norway	699.0
96. Oman	63.1
97. Pakistan	546.3
98. Panama	102.2
99. Papua New Guinea	65.9
100. Paraguay	48.4
101. Peru	330.9
102. Philippines	440.4
103. Portugal	376.6
104. Qatar	114.9
105. Romania	523.4
106. Rwanda	43.8
107. St. Lucia	7.5
108. St. Vincent	4.0
109. Sao Tome & Principe	4.0
110. Saudi Arabia	3,202.4
111. Senegal	85.1
112. Seychelles	3.0
113. Sierra Leone	57.9
114. Singapore	250.2
115. Solomon Islands	5.0
116. Somalia	44.2
117. South Africa	915.7
118. Spain	1,286.0
119. Sri Lanka	223.1
120. Sudan	169.7

Proposed Quota
(In millions of SDRs)

121.	Suriname	49.3
122.	Swaziland	24.7
123.	Sweden	1,064.3
124.	Syrian Arab Republic	139.1
125.	Tanzania	107.0
126.	Thailand	386.6
127.	Togo	38.4
128.	Trinidad and Tobago	170.1
129.	Tunisia	138.2
130.	Turkey	429.1
131.	Uganda	99.6
132.	United Arab Emirates	385.9
133.	United Kingdom	6,194.0
134.	United States	17,918.3
135.	Upper Volta	31.6
136.	Uruguay	163.8
137.	Vanuatu	9.0
138.	Venezuela	1,371.5
139.	Viet Nam	176.8
140.	Western Samoa	6.0
141.	Yemen Arab Republic	43.3
142.	Yemen, People's Democratic Republic of	77.2
143.	Yugoslavia	613.0
144.	Zaire	291.0
145.	Zambia	270.3
146.	Zimbabwe	191.0

INTRODUCTION OF SENATORS

Senator KASTEN. Mr. Secretary, we thank you.

Mr. Secretary, I would like to point out that we have been joined by two additional Senators who do not usually attend our hearings.

First of all, we are very pleased we are joined by the ranking member of the Appropriations Committee, the Senator from Mississippi, Mr. Stennis.

Do you have any comments, Mr. Stennis?

Senator STENNIS. Thank you very much. Let me come a little later, if you will. I just walked in.

Thank you very much.

Senator KASTEN. We are also joined by Senator Gordon Humphrey, the Senator from New Hampshire, who has a keen interest in this issue. We have invited him to join us in these 2 days of hearings. He will participate in the questioning after the members of the subcommittee have had an opportunity to ask questions.

BANK BAILOUT

Mr. Secretary, you pointed out, and I don't think that anyone needs to tell you, that many believe that this request is simply a bailout for the commercial banks who made these huge loans, gambled that inflation would stay high, oil prices would stay high, and growth rates would continue. The gamble did not pay off, and now critics contend the IMF is simply going to bail these banks out with no penalty to their stockholders or to the individual officers who made these loans.

Those of us in political life have a responsibility to answer this criticism. I must say it is coming from taxpayer groups throughout the country.

How would you answer that question and specifically why should these large institutions get off without paying any penalty on the loans on which they gambled and effectively lost?

Mr. REGAN. Let us talk about the banks first of all from the point of view of the amount that they have loaned and how they have entered this situation. The banks having gotten themselves into this situation, should we leave them in the situation or what should be done about it?

The IMF was set up under the Bretton Woods Agreement among the nations of the free world in order to have liquidity in the world's monetary system so that members could, when there were times of illiquidity among nations for any number of reasons, have funds available to tide their particular nation over. Funds were subscribed by all the member countries.

At this time, regardless of whether the loans were good, bad or indifferent, nations are in trouble. The question is should other nations come to the rescue of those nations? Let us set the banks aside for the moment.

If you say yes, nations should rescue other nations trying to make a go of it, and that they should have a fund to draw on when they are in difficulty, then you are in agreement with what has happened in past practice with the United States under both parties' administrations.

The United States is the second largest borrower from the IMF or the second largest user of the IMF funds over the period of years, the largest being Great Britain. Thus, the IMF is not strictly for the less developed countries.

The crisis we face today concerns the least developed nations and what has happened to them. They have been caught in the oil squeeze, there is no doubt about it. On the one side you have the oil importers who had to pay more for oil and had to borrow in order to be able to handle their own internal situation as far as the cost of oil is concerned.

On the other hand, the banks had surplus funds coming from the oil exporting nations and acted as intermediaries between lenders and borrowers. We can sit down and second-guess as to whether these were good loans or not. It would depend on how the loan officer in 1979, 1980 or 1981 actually assessed the future for Mexico, for Brazil, for the Argentine, and so forth.

In the case of many of the banks they decided the outlook was pretty good, so they continued to loan money. But the world recession in 1982 reduced borrowers' ability to keep up their payments, and as a result repayments had to be stretched out.

Now comes the question, is it a bailout for the banks? The IMF is not putting up money that will supplant bank money in these nations. The banks will indeed have more money in loans to these countries at the conclusion of the IMF program than they had when the program actually started. So the banks are not getting out.

Are the banks being penalized? They are only being penalized to the extent that with the stretch out of the loan they don't get the principal back as quickly as they thought they were going to have it. They will not have it available for future loans.

To that extent they are penalized. There have been some bank losses because of a few nations such as the Sudan and other nations of that nature. The new bill that has come out of the Senate Banking Committee and a companion piece that is coming out of the House Banking Committee does put more restrictive provisions on the banks concerning disclosure of foreign operations, amortization of rescheduling fees, and generally closer regulation by the regulators, the Controller of the Currency, the Federal Reserve and the like.

So, indeed, the banks are being penalized on this. Hurt? No. Penalized? Yes, as far as what they have done with loans to some of these developing nations.

ADVERSE CONSEQUENCES OF INCREASE

Senator KASTEN. Mr. Secretary, critics of an increase in our IMF quota pointed to adverse political as well as economic consequences.

Let me just quote from, first of all, Bill Simon when he says:

When we agree to add to the IMF till, we transfer our resources to a supranational organization that we do not control, to be disbursed by an international bureaucracy. The multilateral approach has the advantage of dragging others into the aid process, and the U. S. isn't left alone holding the bag, but the disadvantages are great. It is hard to hold multilateral middlemen accountable, and we get in the habit of subsidizing every socialist government in the Third World.

Paul Craig Roberts says:

Passing foreign aid through an international bureaucracy reduces the control of influence of the donor countries. The ultimate result is to divorce foreign aid from the policy interest of the United States and the NATO alliance. When we let the IMF disburse our money for us, we cannot extract political and strategic benefits from the recipient countries on a quid pro quo basis.

In your opening remarks you pointed out the importance of world trade. Why aren't we better off dealing in direct bilateral foreign assistance as opposed to pouring more and more dollars into this, as former Secretary Simon says, supranational organization with these disadvantages that both these two gentlemen point out?

Mr. REGAN. First of all, we must assume that we do want to help these other nations. A U.S. decision to go isolationist is an entirely different thing.

Senator KASTEN. Multilateral versus bilateral.

Mr. REGAN. The IMF has disbursed close to \$60 billion or has committed close to \$60 billion to the less developed and the developing nations in order to help them over the last several years.

We are asking for an increase in the quota of another \$33 billion over the next 5 years in order to continue to help these nations. I doubt, Mr. Chairman, if the United States would or could have come up with direct loans to other nations of that size, some \$60 billion, over the last 3 or 4 years.

There is no way we would have gone for that. Therefore, we would have cut back sharply on that amount. We would then have to decide how we would spend it and where we would spend it, but having spent it, then if another nation suddenly becomes a cropper, you don't have that money available and you would have to go around trying to raise it.

What I am suggesting is that in the multilateral organization you get leverage on your money. We are able to influence somewhat how the money is disbursed, but at the same time we certainly can take a few dollars and make them leverage into a lot more dollars by using other people's money, as well as our own in helping these nations, and in the long run we benefit from this because our exporters can compete in the marketplace of those nations as we are in Mexico and Brazil. We benefit from not having those nations go under.

IMF LOANS TO SOCIALIST COUNTRIES

Senator KASTEN. Could you comment specifically on the criticism that the United States is in the habit of subsidizing every socialist government in the Third World?

Aren't there governments that the IMF is working with that we would not choose to work with, at least to the degree that the IMF is, if we were in a bilateral arrangement?

Mr. REGAN. I would be less than candid, Mr. Chairman, if I did not admit there are some governments that have IMF loans whose policies, political philosophy, we probably do not approve of or would not approve of.

On the other hand, if we start picking and choosing among these nations in this way, what is to stop other nations from doing the

same thing to us? That is, would they support nations that we are friendly to?

In politicizing this process you end up with the worst of all worlds. Suppose people said we should not support loans to, say, South Africa? What about a nation that for religious reasons is discriminating against women? Should we deny IMF financing to the entire Moslem world?

If members were to decide on some arbitrary basis that they don't like a particular philosophy or country and try to force their views on IMF operations, the IMF would soon be a political institution.

It was decided at the time of Bretton Woods, and I think our predecessors for years have held to this view, that the place to discuss politics is in the United Nations. The IMF and the World Bank were supposed to stick strictly to finance and economic issues.

Who is going to decide which nation gets financial help? By virtue of the size of its contributions, the United States has a veto over major IMF decisions like changing the constitution and things of that nature, but we do not have a veto over individual loans.

Senator KASTEN. Senator Inouye.

Senator INOUE. Thank you.

BUDGETARY AND FINANCIAL IMPACT

Mr. Secretary, before proceeding with my questions, I would like to have some clarification. As you know, this is budget time and everyone is concerned about money. I think many people have the impression that we are going through a process where the United States is called upon to pour billions of dollars down the drain.

You are seeking or recommending an increase in our quota in IMF by 5,310,800,000 SDR's which is approximately \$5.8 billion.

Mr. REGAN. Yes.

Senator INOUE. You are seeking budget authority. There are absolutely no outlays, isn't that correct?

Mr. REGAN. That is correct. There are no net budget outlays. If this quota increase goes through, the IMF then has a right to call on the United States to loan to it up to 5.3 billion SDR's.

If they call upon us, we have to translate that into dollars. They would call upon us, let us say, for \$1 billion or \$2 billion at a time. We would go into the open market and borrow those dollars and loan them to the IMF. They would pay us a market-related rate of return on that money. For each dollar transfer to the IMF we would get back an equivalent asset, an asset that would be in some ways comparable to our gold in Fort Knox. So on our balance sheet we have had an outlay, and we have had a receipt. We have balanced off an asset and a liability, with no budgetary implication.

Senator INOUE. Isn't it true that throughout the life of the IMF we have never had any outlay?

Mr. REGAN. That is correct.

Senator INOUE. So we are not talking about money going down the drain?

Mr. REGAN. No. Most people associate this with a foreign aid program. It is not foreign aid. It is loaning money to an international

institution and which in turn loans it to other members of that international body.

U.S. EXPORTS

Senator INOUE. You cited a few statistics which I believe are deserving of repetition which point out that the United States is very much dependent upon overseas development and overseas markets.

For example, you said that about 20 percent of our industrial output is export, 1 in 6 workers depends on exports for his job, 2 out of every 5 acres of farmland produce for export, nearly one-third of U.S. corporate profits come from international activities. I am certain everyone here will agree that we are very much dependent on what happens in the outside world.

Would you agree from your perspective, as Secretary of the Treasury, that economic problems and troubles abroad are real and present dangers are on the order of, if not surpassing, the military hazards around the world?

Mr. REGAN. I guess I am prejudiced, Senator, but I do think that economic conditions are at this point just as grave as military threats. If we lose the economic game, the consequences of that to the United States, to our recovery, and so forth, are hard to imagine, they would be so bad.

It would indeed be a tragedy if we were to get into a major recession as a result of failures of major countries to be able to sustain themselves in the international trade arena. That is all we are talking about here.

Countries want to meet the interest and principal payments on their debts in order to facilitate trade. If they don't do that, there will be no money lent to them and they couldn't import or export. The result would be a total collapse of the world trading system.

Senator INOUE. In other words, what you are telling us is that we should be concerned about what happens to Mexico, what happens in Zimbabwe, and what happens in Indonesia and elsewhere?

Mr. REGAN. We have to be.

Senator INOUE. If they go under, we may go down under.

Mr. REGAN. We would certainly feel it. Whatever happens to the larger developing countries will really affect us. As I said, Mexico is our third largest trading partner. You can't afford to have your third largest trading partner fail and not suffer serious consequences not only on the borders, but indeed throughout the entire United States.

ANNUAL INTEREST RATES CHARGED

Senator INOUE. I would like, Mr. Secretary, to follow up on the Chairman's questioning on the bailout of big banks.

Recently there was an article in the Washington Post that suggested that private banks in the United States and abroad have been charging Mexico about \$800 million as a price for maintaining their lending relationships with that country. Is that correct?

Mr. REGAN. That figure refers to annual interest payments on total debt of about \$80 billion to the world at large, not just to the United States.

The London bank rate of interest now is about between $8\frac{1}{2}$ and 9 percent. Mexico pays about 1, $1\frac{1}{2}$ percent over that on average. It has increased recently to over 2, but on average their entire debt would be somewhere in the neighborhood of $10\frac{1}{2}$ or 11 percent. It is easy to see where the \$800 million comes from.

Senator INOUE. Is the charging of these special fees or special rates extraordinary or unusual, from your background as a banker?

Mr. REGAN. No, it is not unusual. That is the way most international rates are set, either a percentage point or some fraction of a percentage point above the London bank rate or a percentage or so above our prime rate. That is the normal way that commercial rates are set between nations and their creditors.

Senator INOUE. Not being a banker, I would like to get some clarification. It has always been suggested that income from these fees is going to profit and not into reserves. What is the significance of that?

Mr. REGAN. A bank will set aside reserves depending upon the amount of deposits and loans that it has. Earnings on its commercial loans, whether they be to sovereign governments or to corporations or to individuals, is the income that they make.

After expenses this becomes their profit. After you deduct the cost to the banks of the money they are loaning, you are left with a spread that is bank profit. It becomes profit after taxes.

BANK PROFITS FROM INCREASE

Senator INOUE. Is this true, as some have charged, that these banks will profit from the increase in the quota to the IMF?

Mr. REGAN. Not directly from increase in the quota. I think what is referred to there is that when an IMF program is put into effect there is usually an adjustment in their loan situation. Where the loans are usually extended. Because loans are extended it means that the country is a greater credit risk than it was formerly.

It is normal when assessing credit risk that you charge more to the least worthy of debtors than you do to the better credit risks. As a result, the rate on the loans, the new loans, that are being charged by the banks to these nations increases. The banks see more danger of loss and demand a better rate of return.

Now, to the extent that the IMF program makes that a stronger nation and to the extent that that IMF program helps the nation to pay off its debt, indirectly I suppose you could say that the IMF program is helping the banks, but that is purely a secondary consideration.

POSSIBILITY OF NEW BANK LOANS

Senator INOUE. You suggest in your statement the possibility that the banks may pull out entirely from making new loans this year?

Mr. REGAN. Without naming any nations, let us suppose that a nation were to declare a moratorium, a default, if you will, on its debt. There is not a bank in the world that is going to say to that nation, OK, we will lend you more money. That is not done when a moratorium is declared.

The classic case right now is Poland. Poland is not paying, the banks and the banks are not loaning any more money to Poland. They are in the process of negotiating to see what can be done, but in the meantime no new loans are being made.

As a result, Poland finds it difficult to trade with anyone except through barter and through its Comintern arrangement. It cannot trade normally with the West. This is what would happen were a nation to default.

MEXICO

Senator INOUE. My next question does not relate to IMF, but it does relate to our financial relationships with other countries.

In response to Mexico's debt crisis of last August the United States provided \$1 billion in Treasury exchange stabilization funds, \$1 billion in loan guarantees from the Commodity Credit Corporation, and \$925 million from the Federal Reserve. When you add it up, these sums would amount to about twice as much as the Congress provided in appropriations for multilateral development assistance programs for fiscal 1983.

Was congressional approval required for the specific authorization of this assistance to Mexico?

Mr. REGAN. No, sir, it was not. The Exchange Stabilization Fund was set up by the Congress in 1933 or 1934 when we went off the gold standard to stabilize the dollar vis-a-vis other currencies. The Fund used some of the profits from marking up our gold when we went up on the price of gold at that time.

It is under the supervision of the Secretary of the Treasury, who operates with the permission of the President of the United States. The moneys are to be used strictly to stabilize currencies.

What happened with Mexico was that they were in danger of having the Mexican peso and the dollar suddenly in a distorted relationship. In order to smooth that out we loaned Mexico a billion dollars for a very short period, a couple of weeks, to stabilize their currency.

Now, that was paid back to us. It was paid back to us when we made a deal to fill our strategic petroleum reserve at a faster rate, using Mexican oil which are paid for up front.

Second, CCC credits have already been authorized by the Congress through the Secretary of Agriculture. Sales through the CCC program were perfectly proper. The Secretary of Agriculture did that.

The third part again, the Federal Reserve part, is permitted under the rules that the Congress has set up for the Federal Reserve. In no case was this foreign aid. These were all loans against purchases and for a specific purpose.

ILLEGAL ALIENS FROM MEXICO

Senator INOUE. My final question, Mr. Secretary, may seem to be a bit unreal and hypothetical, but I think it has some sense of realism.

If Mexico should experience greater failure in the economy and the crisis gets worse, would the number of those Mexican men and

women coming across our borders, illegally or otherwise, increase or decrease?

Mr. REGAN. Mr. Chairman, I have said it would increase. It is logical to suppose, knowing that there might be employment north of the border, that many in Mexico faced with an economic crisis would try to cross the border legally or illegally seeking jobs here, and as a result, our problems would be exacerbated as far as finding help for them or returning them to their own country.

Senator INOUE. Is that one of the matters that should be of concern to us?

Mr. REGAN. Very definitely. I know that it is a primary concern of many people who live in the border States with Mexico. If there is no IMF program and financial backing for Mexico, our problems with a very close neighbor and very large trading partner are going to be in a sad condition.

Senator INOUE. Thank you very much.

Senator KASTEN. Senator Specter.

Senator SPECTER. Thank you.

RESERVE FUND

Mr. Secretary, last month, as you know, the Treasury Department organized a delegation to visit Mexico, Peru, and Brazil. I compliment the Department and its personnel on a very excellent agenda and information on this subject.

During the course of that trip there was an opportunity to get rather deeply into various aspects of the IMF issue. As I understand the figures—at least those that were current a month ago or 5 weeks perhaps—there were some \$70 billion of funds in the IMF and some \$32 billion which could be loaned.

Of the \$32 billion, some \$19 billion had been committed; of the \$19 billion, some \$7 billion had been expended, which would leave some \$13 billion and some \$12 billion committed, not actually expended, plus the IMF has the power to borrow, and one major question which is on my mind is why is that insufficient at the present time or for a reasonable projection to cover the kind of financing that the IMF may be expected to need?

Mr. REGAN. Are you talking about the \$13 billion that is uncommitted or are you talking about additional borrowings besides that?

Senator SPECTER. I am talking about the overall picture. If you start with the \$13 billion which is uncommitted, that, of course, is available for loans. Then you have \$12 billion of what is committed which you may be able to use in the interim. You may need more funds, but that may last for a while.

Mr. REGAN. I want to check for a minute on what the up-to-date figure is, Senator.

Senator SPECTER. Mr. Secretary, I think we can agree our sources are the same.

Mr. REGAN. I just wanted to check to see if there had been any recent drawings from the IMF. I have been out of the country, as you know. The figures are somewhat lower than yours, but they are approximately the same.

The IMF must keep reserves on hand because any member including the United States can draw down funds against liquid

claims on the IMF. They don't have to borrow money from them. They can draw down from whatever they have. So they have to keep a certain amount in reserve.

The majority feeling is that somewhere in the neighborhood of \$10 billion or so has to be kept on hand at all times because a major nation might step in and borrow, or a series of major nations might want to draw down their IMF reserves. So, you keep that reserve.

So, maybe \$7 or \$8 billion would actually be available. Of course, you couldn't allow fund resources to go down all the way to zero again because the IMF must be able to honor members claims on their reserve positions.

Senator SPECTER. That is a fair amount of money available for lending.

Mr. REGAN. I point out to you at one point the United States borrowed as much as \$3 billion. We don't know what another nation might want to borrow.

France has just borrowed \$3.7 billion from a similar fund in the EC. So, there are nations that could come in and ask for large amounts. The IMF has to keep the reserve on hand. It operates just like a bank in this sense.

We are talking again about a 5-year period. We are not talking just what we are going to need in 1984. We are trying to look ahead. I don't think we can afford to say, well, let us slide by 1983 and let us try to see if we can get by 1984 and maybe go for an increase in 1985.

We think it is more prudent to get sufficient resources now, when the danger is now, and the world is in recession. True, the United States is coming out of its recessionary period, and we hope the other nations will be coming out soon also, but we don't know that for sure.

Therefore, prudence would indicate that we should have an increase in the quota now rather than waiting until it is absolutely necessary and the bank is broke.

BANK BAILOUT

Senator SPECTER. Mr. Secretary, I share Senator Kasten's concern about the bailout issue. I think it is a complex one in a number of ways. I do not think that bailout is perhaps the most accurate term, but preferential treatment might be a better term.

I understand your definition of bailout when you say there is no substitution for money which the banks have in at the present time. But the concern that I have arises over the interest rates which the banks are charging which many have said, and I would agree, are excessive under all the circumstances.

Then you have the banks taking the proceeds on premiums and putting it into their earnings account. You have banks, which I understand are capitalized somewhere in the \$4 billion range, which have loans outstanding in the \$80 billion range, and if they were to have a realistic appraisal of the value of the loans, they would be insolvent, but they value the loans as good loans and then in the interim they pay dividends.

Now, my own sense is that the banks or institutions should have substantial flexibility in putting value on an outstanding loan, say it is a bad debt because it is in default, but it may be salvageable, but in a situation where the loans are highly questionable and if you were to have to sell them at a given loan, the bank might well be insolvent, it seems to me it is wrong for that bank to be paying dividends when they collect extra premiums from Mexico to put in earnings and classify that as a fund on which they can pay dividends.

That seems to me to be just very wrong, perhaps even criminal, if you take a hard look at whether they have any earnings that should not be against reserve or their capital is impaired.

I would be interested in your reaction.

Mr. REGAN. I will try to make a short answer, but it is a complex question and a complex problem. This happens no matter whether it is a sovereign loan or whether it is a corporate loan or individual loan.

At what point does the bank decide that a loan is no good, charge reserves for it, and write it off? This is a matter of judgment among the banks and it differs among banks as to when they charge off and when they don't.

The regulatory agencies, the Comptroller, have been going into the banks and examining them. FDIC and the Federal Reserve are watching this type of thing and making decisions for the banks. I don't need to tell you that in recent months, recent years, we have had several major problems in the United States on domestic loans.

We had the problem with REITS about a decade ago. The banks continually get into situations which require a decision as to when and by how much to write off loans. As far as the sovereign loans are concerned, it is again a matter of judgment as to whether a nation is going to default at some time or not.

I don't want to be sarcastic, Senator, but I do, as Secretary of the Treasury, have to point out that we in the United States have never paid off our debt. We never pay it off. We just roll it over week after week, month after month, year after year, and increase it.

Senator SPECTER. You are not being sarcastic. I think you are being realistic.

Mr. REGAN. I don't want to be sarcastic.

Senator SPECTER. If it is sarcastic, it is most directly attributable to the Secretary of Treasury.

Mr. REGAN. No, because we don't have charge of the budget.

Senator SPECTER. Who does?

Senator KASTEN. That was sarcastic.

Mr. REGAN. Nonetheless, the points that you make have been well taken and Senator Heinz and Senator Proxmire have come together in the Senate to try to rectify this in the Banking Committee.

HEINZ-PROXMIRE BILL

The Heinz-Proxmire bill speaks to all these issues including the fee issue. Their bill provides that renegotiation fees no longer be entered as profit, but be amortized over the life of the loan.

Indeed, some have suggested that such fees should be put into the reserves, but the bill at this time does not call for that. I think that you will find, if you make a close analysis of the Heinz-Proxmire bill, that it will, at least in my judgment and that of the regulators, suffice to make certain that the banks are not getting away with anything in future renegotiations of loans as they might have in the past.

INTEREST RATES

Senator SPECTER. On that subject why is the interest so high? Traditionally the rate of interest is calculated at the inflation rate plus 2 or 3 percent and the interest rate now is so high—what is the interest rate being charged to Mexico, 11 percent or 12 percent?

Mr. REGAN. It is 2.67 over Libor. It will be about 11½.

Senator SPECTER. That seems to me to be most excessive given the inflation rate. The banks are really profiteering from circumstance.

Whether you call it a bailout or not, if the United States does not come in with the IMF loan and if Mexico has to shift for itself, Mexico is going to default on those loans and the American banks are going to have bad debts and the American banks may well be insolvent. I understand the complexity of the problem, and it is very much contrary to our national interest to have our big banks go under. It will hurt everybody, not just the stockholders of the big banks.

Why in this situation should we tolerate their continuing to collect 11½ percent when the inflation rate is 3.9 percent and then we come back around to rearrange the financing through the IMF to save what would otherwise be bad loans?

Mr. REGAN. Again this is part of the overall problem of high interest rates. Most nations of the world—at least I have been repeatedly told this over the last 3 weeks as I traveled—feel that the high interest rates in the United States are causing these problems.

The London bank rate of approximately 9 percent reflects the 10½ percent prime in the United States. If the 10½ percent rate comes down, then all other rates will also drop.

I am willing to spend as much time as you want on whether or not we have high rates of interest in the United States. But the other point that I would make is that ordinarily the worse credit risk you are, the higher rate of interest you get, not the lower rate.

A nation that has had to renegotiate its debt, which indicates it is weak, will normally be charged more than a strong creditor will. The difference between a triple A and B rating in bonds, it is the same thing among nations. The worse the credit risk, the higher the interest rate.

COMMODITY SUBSIDIES

Senator SPECTER. One more question, Mr. Chairman. That relates to the issue of subsidies which foreign governments like Brazil are extending to commodities like steel which is coming into the United States and is a major problem for the country generally, especially for a State like mine, Pennsylvania.

When we were in Brazil, I raised this question directly and the facts are plain that Brazil steel is subsidized. Given 13.8 percent unemployment in Pennsylvania and the impact on the steel industry, there is tremendous hostility out there in the open houses that I attend as to foreign aid or any aspect of it.

The people simply cannot understand why we are spending money overseas when they are unemployed and health benefits are lapsing and mortgages are being foreclosed. It seems particularly acute when we are loaning money to Brazil which has been subsidizing, and that is not protectionist.

Free trade means fair trade, and that is the absence of subsidies. Isn't there something that can be done to stop our money from being used to subsidize foreign imports which drive our people out of work?

Mr. REGAN. Your point is well taken concerning subsidies in countries with IMF programs. This is one of the points we have made in the last 6 or 8 months very strongly to the IMF leadership and management. They are acutely aware of this. In fact, with both the Mexican and the Brazilian programs the IMF has repeatedly insisted that part of the IMF program is an elimination or reduction of these subsidies.

Senator SPECTER. Why cut them back? Why not cut them out? Why give them any latitude at all?

Mr. REGAN. This is the reason. If you cut out the entire subsidy at this moment, you will throw an additional 300,000 or more Brazilian workers out of a job.

Senator SPECTER. Mr. Secretary, we have 300,000 here out of work.

Mr. REGAN. Yes, but that is not entirely attributable just to Brazilian steel. If it were directly traceable to Brazilian steel, we could rectify the problem overnight. If we shut down every steel mill in Brazil tomorrow, Pennsylvania would still have the problem.

Senator SPECTER. Why should we have unemployed steel workers in the United States when they are losing their jobs because of subsidized Brazilian steel we are paying for, even one?

Mr. REGAN. From the point of view of Brazilian steel coming in here, we are trying to cut back on that. Those who are using steel here, however, are getting the steel cheaper and it means we have cheaper imports.

I recognize the problem that you have brought up. We are trying to correct it, but I don't think we can correct it overnight.

Senator SPECTER. It takes a lot more time than I have.

Senator RUDMAN [presiding]. Senator Stennis.

Senator STENNIS. Thank you, Mr. Chairman.

RELIEF PROGRAMS FOLLOWING WORLD WAR II

Mr. Secretary, I don't keep up with this subject matter. I am interested, but you can't keep up with everything on the Appropriations Committee. I heard you were going to testify, so I changed appointments I already had to get over here to hear you. I am not just bragging on you now, but you know your subject.

I know when you first became Secretary of the Treasury we talked about the problems confronting the budget and social secu-

rity. You don't remember it, but I spoke then of a commission to get into that problem. This is a very serious matter.

The first vote I cast here, Mr. Secretary, was the forerunner of what became known as the Marshall plan. The country was almost stagnated. We had just won the war. We couldn't buy an automobile; they would put you on the waiting list. They were not coming out then. We had not even got cranked up.

It was slow getting the relief programs and getting the country moving again. We had the Marshall plan, of course. Then we had NATO. This problem here now brings back these things to me.

I remember what Mr. Eisenhower said—this is before he was President, I think he was president of a university—he came down here as a witness on NATO before the Armed Services Committee. He said, "Gentlemen, I will stake my place in history on the success or failure of this plan. I believe in it strongly and firmly."

He was asked how many troops was he talking about for Western Europe to be stationed there. He said only a token number, only a token number. I can't be sure whether he described that as a division or not, but I think not. I think he spoke of much less than 100,000. He just wanted 30 or 40,000 I think.

Now we have about 350,000. The last time I looked it up we had about 90,000 dependents over there. It costs a lot of money just for them.

I am not complaining, but where do we stop? How can we carry all this load? I know during the war in Vietnam there was a resolution introduced, bring home half of the troops in NATO. I was handling the appropriations bill. It fell to me to oppose it. I was against it anyway.

But they had 44 Senators on that resolution when it was turned in at the desk, 44 out of the 100. I thought we were gone sure enough, but we rallied and it didn't pass. That shows the people and the Congress, everyone, want to do our share, but where do we stop? Where do we retrench? What are we going to do about this thing?

If we get out of this hole, how do we stay out of the hole on helping these other countries finance their problems? I don't know.

Do you want to say a word on that, the future, I mean?

Mr. REGAN. I am not going to stake my place in history.

Senator STENNIS. I beg your pardon?

5-YEAR INCREASE FOR IMF

Mr. REGAN. I said I am not going to stake my place in history on this issue. I will say this to you, Senator, that this is a 5-year increase for the International Monetary Fund.

Most nations in the world were asking for at least a doubling, if not a tripling, of the quota. Somewhere between \$66 and \$125 billion is what they wanted. We finally convinced them to agree to \$33 billion. Our share of that is about 18½ percent or roughly \$5.8 billion.

This is over a 5-year period or a little over \$1 billion a year over the next several years. These funds are insurance against any contingencies that might arise in the international monetary system which facilitates international trade. I think it is worth it.

It is not a budget outlay similar to the outlay for troops for NATO. It is not aid like our foreign aid to developing nations or our bilateral aid to Egypt or Israel. It is not to be equated with that.

This is a loan. We get an offsetting asset for it. This standby insurance assures the world that there will be some stability in the international monetary system so that recovery can take place.

Senator STENNIS. I have paid attention to what you say because I remember the advice you gave when you first came here as Secretary of the Treasury. Some of it turned out to be mighty good.

You talk about insurance. We are just putting up an insurance fund. How much, say, are we going to have? Are we going to be on the board of directors on how this matter is handled?

Mr. REGAN. We have an Executive Director who votes at the IMF. We vote our proportional share which is about 19½ percent. So, we will have a voice in how this is spent, yes sir.

Senator STENNIS. The 18 percent we put up. The other percentage would be 82. Who is putting that up?

Mr. REGAN. The other nations of the world, primarily the industrialized nations of the world, Germany, Great Britain, France, Japan, the EC countries and the like.

Senator STENNIS. You need not answer this question unless you want to, but if we don't put up ours, how will that influence the others?

Mr. REGAN. They will not put up theirs.

Senator STENNIS. I thought that would be your answer. I didn't want to put you on the spot. I am just going to say that that is what I believe about it frankly. The further I go into it, the more difficult this problem becomes for me so I am going to quit.

Thank you very much.

Mr. REGAN. Thank you, Senator.

Senator RUDMAN. Thank you, Senator Stennis.

Senator Humphrey.

Senator HUMPHREY. Thank you, Mr. Chairman.

It is very kind of you and members of this committee to let me participate in this important hearing.

SUCCESSFUL COMPLETION OF 5-YEAR CYCLE

A moment ago, Mr. Secretary, you referred to the 5-year cycle. You pointed out that this quota increase is to cover the next 5 years. This ties in with what Senator Stennis had to say about falling back into the hole.

Despite the fact that this is advertised as a 5-year recovery period, we know the 1980 increase was likewise supposed to be a 5-year recovery period. Here we are 3 years later going to increase it again.

What confidence do you have that we will make the full 5-year cycle this time and does not the slinking time between quota increases indicate that this spiral of debt and lending is speeding up and deepening with every passing year?

Mr. REGAN. There are a couple of answers to that, Senator.

First of all, the increase is necessitated at this time because of the worldwide recession which is the most severe recession that the

world has seen in quite a few decades. The recession caused a much larger demand for IMF funds than was anticipated when quotas were last increased in 1979-1980.

No one was forecasting such a deep and long recession. I think your outlook as to whether or not this will suffice for 5 years depends on whether you think the world can recover over the next year or 2 and sustain that recovery through the 3 years beyond that. If we do experience a major recession even these new funds may well be eaten up.

Senator HUMPHREY. The purpose of my question was to make the point that even though these increases are advertised as covering a 5-year period, that in fact, they don't. The last one covered 2½ years or 3 at the best. Who knows what this one will cover?

COMMODITY SUBSIDIES

In any case, I wanted to pick up on a line of questioning that Senator Specter started. I thought his questions were excellent.

This matter of the United States extending its hard assets, as we will be doing with this IMF quota increase, this matter of extending hard assets to other countries who subsidize industries which compete with our unsubsidized industries, the net effect of which is a loss of American jobs. Senator Specter is concerned about steel.

Members from the copper States are concerned about copper. Mexico and Chile which are two of the principal countries involved in this IMF proposal subsidize their copper industries heavily.

So we are proposing to extend our hard American assets, so that they can continue this inefficient subsidization of their copper industries, so that they can compete unfairly with our copper industry, so that they can put our copper workers out of jobs.

This does not seem to be a very enlightened policy on our behalf. Of course, this applies to more than just steel and copper. It applies to all kinds of bases and low technology industries. The hallmark of 99 percent of the countries who are in difficulty today on their loans is subsidy, state-owned industry, central planning, all of the hallmarks of inefficiency.

We are proposing not to require them to reform, which they have to do if we let the marketplace operate, but instead to shield them from the marketplace, to provide them the means to continue these inefficient practices.

It does not make sense to me. I am amazed that a man with your background in the business world would embrace such a proposal. I think we should rely on the marketplace and not on political allocation of resources.

Isn't it true that we are throwing American workers out of jobs by enabling countries like Chile and Mexico and others who subsidize their industries to continue that subsidization?

Mr. REGAN. It is hard to trace, Senator, the exact correlation between subsidies for copper in Chile and whether or not American workers are being thrown out of a job. I think the worldwide price of copper has a lot to do with it.

When copper was down to 60 or 65 cents, there was no way domestic companies with high wages could make a go of copper mining. With copper at 82 cents, our mines are starting to reopen.

With copper in the 90 cents, our mines will be profitable. So, domestic production depends on the worldwide price for copper rather than any individual subsidization.

Now, as far as Brazil is concerned, suppose we deny them any money until such time as they knock off the steel subsidy. So, therefore, the steel mills in Brazil for the most part would have to put their workers out of a job.

We export to Brazil \$3½ billion worth per year of American goods. If Brazil has no money, we don't sell them \$3½ billion worth.

I think, this policy would be pennywise and pound-foolish. We would lose \$3½ billion, while saving on whatever amount of Brazilian steel was imported here. I don't know the exact amount of steel we imported from Brazil, but for the record I will submit that.

[The information follows:]

STEEL IMPORTS BY THE UNITED STATES

[C.I.F., dollars in million]

Year	Total steel imports	Steel imports from Brazil	Brazilian steel as percent of total imports
1979.....	\$7,532.5	\$142.4	1.9
1980.....	7,499.2	176.8	2.4
1981.....	11,100.2	260.3	2.3
1982.....	9,678.8	260.9	2.7
1983 (January to August)	4,256.5	231.2	5.4

U.S. SUBSIDIES ON FARM PRODUCTS

The other thing we have to be careful of is living in a glass house and throwing stones. We do subsidize in the United States. I have to remind you of farm products we subsidize and now want to sell in foreign markets in competition with others.

We subsidize sugar and I heard all about this when I was in the Philippines. They ask why do we subsidize sugar at 26 cents a pound when they can produce all the sugar we need for 6 cents a pound?

Senator HUMPHREY. You will have to talk to Congress about whether or not we want to interrupt those subsidies or not. I think we have to be very careful of saying let us wipe out all subsidies. We are working toward that through Ambassador Brock and others in the international trade arena to try to eliminate as many of these subsidies as we can.

Mr. REGAN. We have an agreement with the IMF that as quickly as possible they will encourage these nations that have IMF programs to reduce and then eliminate subsidies.

Senator HUMPHREY. I simply raise the question to make the point, if it was not made clear, that in asking Congress to vote this line of credit, the Treasury is asking us, in part at least, to help countries that undercut our domestic industries through subsidization.

Mr. REGAN. We are asking you to underwrite countries through the IMF programs with whom we trade, as I showed you in that chart with Mexico.

EFFECT OF OIL PRICE INCREASES

Senator HUMPHREY. May we have that chart again?

Let us refer to the other side of the coin. This one deals with Mexico. On first glance that is a rather persuasive looking chart. Every time you see a big red line going down steeply or any colored line going down steeply it arouses your patience.

But in the case of Mexico, as is the case with oil producing nations, they have seen a steep decline in their revenues because of the fall in the price of oil because of the workings of the marketplace.

What this chart does not show us are the lines for all of our trade around the world because many nations, unlike Mexico and other oil producers, have not been hurt by the fall in oil prices, but have been tremendously helped. So they are going to be in a position to buy more from us.

So what we really need to see are the lines that show the trends for worldwide trade, the trade with countries of the world and not just one example. If we saw such a chart, what would we see?

Mr. REGAN. Were I to bring in a red line on that, it would make your heart really break, Senator, because we are going to show a trade deficit this year of \$55 billion to \$60 billion.

Senator HUMPHREY. That is nothing new.

Mr. REGAN. It is not new, but it is much larger than last year. That is the worldwide picture that you ask for.

Senator HUMPHREY. My point is in an unconstrained marketplace I know it is too much to ask for when you are dealing with politicians, but the more we can move in that direction, the better. Where the economy creates an equilibrium, as fortunes of one country decline, the fortunes of other countries are on the ascent.

The net of all of that is anything is an improvement in our position.

Mr. REGAN. I think there is one added dimension here that Senator Specter brought up and that is the rate of interest. High rates of interest make it very difficult for that type of process to function. A country such as Brazil gains from a fall in the price of oil because it is an oil importing nation, but is hurt if interest rates go up, and perhaps much more so than it is helped by the drop in the price of oil.

You have to bring that into your equation also. Were we to get a two point drop in the interest rates, that would save Brazil somewhere in the neighborhood of close to \$1 billion.

Senator HUMPHREY. Yes. Of course interest rates have been dropping. Likewise countries in difficulty have been adjusting their exchange rates and that helped a great deal. There are many things underway of a self-correcting nature, wouldn't you say?

Mr. REGAN. Yes, hopefully. In the meantime we have these liquidity problems. All we are saying is that the IMF acts as a catalyst for solving the liquidity problem.

U.S. INTEREST RATES

Senator HUMPHREY. It seems to me the United States is looked to as certainly the leader in economic circles. If we hope to see interest rates in this country fall, it seems to me we are working against that purpose by first of all draining the U.S. economy over a period of a couple of years perhaps of \$8.5 billion and that is only part of it.

As you know, U.S. banks historically will follow in line behind the IMF on a scale of greater than four to one, perhaps three to one. In any case, what we are talking about here is something on the order of a drain of U.S. assets of something in the vicinity of \$40 billion, not the \$8½ billion.

That is going to act to keep interest rates in this country static if it does not help to push them up.

Mr. REGAN. I would not agree with that, Senator, from this angle. On the current services basis we are getting quite a return from the loans we make abroad and investments we make abroad. Some \$30 billion per year is income to us from these types of loans and investments that our banks and others are making abroad.

So, I would say that we do get a return on that. We are not wasting that money. It is not as though we are giving it away. It is a loan and it does come back in the way of profit.

Senator HUMPHREY. I don't suggest we are wasting it, but it is a question of priorities and where you get the greatest return.

Mr. REGAN. At this particular time I think there are sufficient funds in the United States for both the Treasury and private industry and individuals to have sufficient for their borrowing. I know of no crowding out as yet.

If we were to continue with high deficits, that is something else again. At the moment I think we are in a comfortable position.

Senator HUMPHREY. One difficulty I have had in dealing with this issue is a paucity of hard data on how bad that is. You get all kinds of generalities, all kinds of wisdom, all kinds of tales of how the sky is falling. When you try to reduce it to a hard number it is very, very difficult.

EXPOSURE OF AMERICAN BANKS

Have you or any of your assistants numbers on just what is the exposure of American banks?

One of the arguments of the proponents is that if we don't do something, some American banks are going to be in trouble. How bad is it?

Mr. REGAN. Let us take it by country. Mexico, total U.S. and non-U.S. bank claims—

Senator HUMPHREY. We want just bank claims.

Mr. REGAN. On Mexico, \$64½ billion total; U.S. total, \$24.3 billion or 37½ percent roughly.

Brazil, \$55.3 billion total. United States, \$20.7 billion. Venezuela, \$27.21 billion, total; United States, \$11.1 billion. South Korea, \$20 billion total, \$8.7 billion, United States.

Senator HUMPHREY. South Korea has been able to service its debt without any difficulty, has it not?

Mr. REGAN. So far, yes, sir.

Senator HUMPHREY. That one is not a problem.

Senator RUDMAN. The committee has a figure, Mr. Secretary, obtained from the Treasury that the total exposure of all banks was \$550 billion of which two-thirds was held by the U.S. banks. I don't know if that figure is correct, but that is the figure the Treasury has supplied to the Committee, two-thirds of \$550 billion. Developing countries we are speaking of.

Senator HUMPHREY. If you examine the loans on a country-by-country basis, you find in many cases they are in no danger at all. South Korea has been able to service its debt.

If we are going to focus on the argument that there is a banking crisis, which of these loans and to what dollar extent are in danger?

My figure is that it is about \$75 billion. Would that be about right?

Mr. REGAN. I did not hear all the question, Senator.

IMF PROGRAMS WORLDWIDE

Senator HUMPHREY. In terms of those U.S. bank loans that are truly in danger, the figure is about \$75 billion? Is that about right?

Mr. REGAN. I wouldn't know who characterized it as in danger and what countries they have in mind.

Would you say a loan to Brazil is in danger? Would you say a loan to Mexico is in danger?

Senator HUMPHREY. We are asking you to answer.

Mr. REGAN. I don't agree they are in danger at this point because these nations are trying to meet their obligations. Their political leaders have said they are going to meet their obligations. They have agreed to IMF programs.

By the way, South Korea does have an IMF program which has been in effect for 2 years and they are about to come in for a new IMF program.

Senator HUMPHREY. Who doesn't have an IMF program?

Mr. REGAN. United States.

Senator HUMPHREY. Anybody else?

Mr. REGAN. Yes; There are only about 35 nations that have IMF programs out of a total membership of 146. Whether or not loans are in danger is a matter of judgment.

I for one, particularly as Secretary of the Treasury, in public testimony have not characterized these loans as being in danger.

Senator HUMPHREY. If they are not in danger, then why are we asked to make this premature quota increase?

Mr. REGAN. For other countries that might be in trouble. Remember, these programs have been put into effect already for Mexico, Brazil, Argentina, and the like.

What happens if there are other nations that get into trouble, where will the money be? What we are trying to do is assure that we have a source of funds for those other nations over the next several years if indeed they were necessary.

Hopefully they won't get into trouble and the world will recover. If they do get in trouble, we have to have this standby arrangement.

Senator HUMPHREY. I will terminate with an observation. If these standby funds are there, it will be an encouragement in many cases for these nations not to clean up their act because they know the insurance is there if they need it.

Mr. REGAN. The nations that have IMF programs don't think that is encouragement to borrow more because most of them find the IMF program onerous when it is put into effect.

Senator HUMPHREY. Thank you, Mr. Chairman.

Senator RUDMAN. Thank you, Senator Humphrey.

Mr. Secretary, I think most of the questions have been asked. As usual, your testimony is forthright and candid. I know we always enjoy having you over here. I just have a couple of questions more.

BUDGET OUTLAYS

The first question, Mr. Secretary, has to do with the fact that it seems to me that we are indulging in a bit of legal fiction which we have all agreed to, the Congress and the administration, about this not being considered a budget outlay because there is a corresponding asset. As a practical matter, we have a number of other instances I can cite to you which you know yourself in which we have outlays and we have corresponding liquid assets, and yet we call them outlays.

As a practical matter, in terms of transfer of funds, even though what you are saying is that this is a secure fund from which to borrow back immediately, the fact of the matter is that these are outlays of funds. Am I not correct?

Mr. REGAN. Well, we have from time to time in the past, and I can recite the history for the record if you would like, borrowed or drawn down from the IMF funds when we thought we needed them. During the Nixon administration and the Carter administration we did draw down funds from the IMF.

As the IMF draws on our quota they give us SDR's. We are entitled to use those SDR's if we are in trouble and need them. In the event we did not, the technical reality would be that it would be a borrowing during that year, but it is not an outlay in fact.

When they have drawn down from the U.S. quota, which they have a right to do, the IMF always paid us back with interest.

Senator RUDMAN. Over what time period?

Mr. REGAN. It is usually 1 year, 2 years or 3.

Senator RUDMAN. If we appropriate x amount of dollars in this committee, that is an outlay this year, but it is offset by whatever money is coming in from past payments?

Mr. REGAN. No; they would give us SDR's. We have an asset. We bought an asset which we may later sell in exchange when they pay us back.

Senator RUDMAN. If we are on a cash basis around here, and we are on a cash basis, we are not on an accrual basis, the fact is that we are on a cash basis, and it is an outlay of funds, I believe.

Mr. REGAN. To the extent you loan somebody some funds, what are we doing with Fannie May? Are we loaning money there or is that an outlay?

Senator RUDMAN. The rate of return paid by the IMF to the U.S. fund is less than it costs you in the Treasury to borrow.

Mr. REGAN. That is something we have taken up with the IMF. We are only getting 85 percent of cost. We have asked for 100 percent of cost. We think we will get that through in September.

Senator RUDMAN. There is an old saying in New Hampshire, you can call a horse a cow, but it is still a horse. I know the first part, but I won't state it.

Mr. REGAN. Coming from Massachusetts, I know the answer.

Senator RUDMAN. Mr. Secretary, the second question, is very brief.

I know that IMF membership includes Afghanistan, Romania, Yugoslavia, Vietnam, Kampuchea. According to the IMF publication, Hungary and Poland are applying. There has been discussion, I believe it was with Senator Specter, about multilateral versus bilateral.

Is it time for us to take another look at this question? Yes, we have a real interest in Brazil and Mexico, they are in our hemisphere, and we have a lot of security reasons for wanting to help them.

But if we approve these funds, we will be helping Communist nations. Maybe we ought not do that. Maybe we should establish a fund in our own hemisphere for those nations that are more important to us.

Mr. REGAN. I think we have to make a decision on all multilateral arrangements in the United Nations, UNESCO, UNCTAD, many other types of organizations under the United Nations in which these same nations belong.

The question you have to ask is if you are going to pull out of one, should you pull out of all of them? From the point of view of international policy, we are trying to work with those countries in these international agencies, hopefully toward some type of peaceful arrangement with them.

Whether or not that can be achieved, I will leave to the State Department and others. But from the point of view of international monetary affairs, certainly as far as trade is concerned we are trading with some of these nations.

It was announced this morning that we are going to renegotiate a long-term grain agreement with Russia. Both sides will sit down on June 1 and settle on this. If we are going to sell grain to Russia, the question is should we be in an organization that loans money to some of the Russian satellites?

The issue is complex and has to be settled on a general level rather than individually in this particular agency.

MEMBERSHIP OF HUNGARY AND POLAND

Senator RUDMAN. What is the status of the membership applications of Hungary and Poland?

Mr. REGAN. Hungary's application has been approved for membership. Poland has not yet officially applied.

SHORT MONEY SUPPLIES

Senator RUDMAN. The final question I have relates back to some of your prior testimony.

Back at the time that we had very short supplies of money, and the reports on short money supplies in the Federal Reserve, as well as short supply of long-term instruments, particularly home mortgage financing, and so forth, banks in this country were making rather large loans to these countries at rates that were very favorable to them, in a real sense contributing to the short money supply in this country.

Is that an incorrect conclusion?

Mr. REGAN. It depends on the period of time when money was in short supply, and whether you refer to loanable funds or the money supply.

If it is loanable funds, there really has not been a shortage. There has been a shortage of loanable funds at a price.

Senator RUDMAN. That is what I am really saying, at a price.

Mr. REGAN. As to the question of whether this money had been better lent at home rather than abroad, you have to look at the purposes for which the money is loaned.

If it is loaned for international trade, which means jobs here or export of manufactures or some of our feed stocks, then you would have to say that that equates with loans at home.

If it was for some purpose other than that, it might be a judgment call at this particular moment.

It is very hard to say what would have happened had that money remained at home. Would it have been invested or would it have been invested in our own debt? I don't know.

Senator RUDMAN. Mr. Secretary, we thank you very much for your testimony this morning. Tomorrow we will receive testimony from Mr. Paul Craig Roberts, professor of political economy at the Center for Strategic and International Studies, Georgetown University; Jack Pierce on behalf of the U.S. Chamber of Commerce; Philip Moon on behalf of the Bankers Association for Foreign Trade; and George Clark, executive vice president of Citibank.

SUBMITTED QUESTIONS AND RELATED MATERIAL

Normally we allow 3 weeks for questions submitted for the record and the responses from the administration. Unfortunately, in this case, Mr. Secretary, the full committee is going to be considering the request next week. We will very much appreciate your responses at the close of business next Tuesday.

Mr. REGAN. We will try to get them in sooner than that, if possible.

Senator RUDMAN. Again, thank you very much for your appearance. We will also place in the record following the questions and answers the additional material submitted by Senator Kasten.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR KASTEN

Senator Kasten: Two years ago IMF staff position papers advocated an increase in the quota as high as 200%. At that time the word from the administration was that perhaps no increase was necessary. Is the 50% increase in the quota enough, or are you going to be coming back to us in 18 months or so asking for additional funding?

Secretary Regan: At the outset of the current quota discussions in 1981, many IMF member countries favored a doubling or even a tripling of quotas, arguing both that large payments imbalances were likely to continue and that the IMF should play a larger intermediary role in financing them. While agreeing that quotas should be adequate to meet prospective needs for temporary financing, the United States felt that effective stabilization and adjustment measures would lead to a moderation of payments imbalances, and that a massive quota increase was not realistic or warranted. Nor did we feel that an extremely large quota increase would be the most efficient way to equip the IMF to deal with unpredictable and potentially major financing problems that could threaten the stability of the system as a whole, and for which the IMF's regular resources were inadequate.

Accordingly, the United States proposed, and the IMF's Interim Committee ultimately accepted, a dual approach to strengthening IMF resources:

- First, a quota increase which, while smaller than many others had wanted, could be expected to position the IMF to meet members' needs for temporary financing in normal circumstances.
- Second, expansion of a contingency borrowing arrangement (the General Arrangements to Borrow) that would be available to the IMF on a stand-by basis for use in situations threatening the stability of the system as a whole.

The increase in quotas coupled with expansion of the GAB should provide the IMF with sufficient resources to meet both routine and emergency demands. We do not believe that, with ratification of the proposed resource increase, further review of IMF resources will be necessary prior to the regular review scheduled for 1988.

Senator Kasten: Mr. Secretary, how would you characterize the foreign policy considerations of this request for the United States?

More precisely, what would be the foreign policy implications of Congress's failure to enact this measure?

Secretary Regan: Failure to enact this legislation would severely cripple the IMF's ability to promote adjustment. This would undermine the centerpiece of the U.S. strategy for dealing with the current debt situation, endanger domestic and international recov-

ery, and aggravate social/political tensions in many countries undertaking adjustment. U.S. influence in the IMF would be sharply reduced, as would the general U.S. leadership role in international economic affairs.

Senator Kasten: Mr. Secretary, it is argued that one of the principal advantages of the International Monetary Fund is its ability to place conditions on its loans forcing countries to change those economic habits which got them into trouble, including efforts to reduce rates of inflation, budget deficits, etc. Many of the developing countries have argued for softening these conditions, while on the contrary, I would argue that IMF conditionality should be tougher and geared more toward market forces than Government intervention. What is your view?

Secretary Regan: I strongly agree that effective conditionality is the most important aspect of IMF financial operations. By conditioning its financing on the adherence to economic performance targets, the IMF plays a key role in helping countries correct the causes of their balance of payments problems and restore a sustainable external payments position. Conditionality aims at assuring the IMF that the economic adjustment program proposed by the government is technically coherent and effective, that it has a reasonable chance of being implemented, and that IMF resources will be repaid. Ineffectual IMF conditionality would result in countries using up their access to scarce IMF resources without adequately adjusting, making the inevitable adjustment even more difficult. The IMF's catalytic role in encouraging additional capital inflows to countries undertaking IMF supported adjustment would be undermined by ineffectual conditionality, resulting in less overall financing for many countries in balance of payments need.

In general I believe IMF conditionality is being applied appropriately. IMF programs set broad macro-economic targets such as levels of fiscal deficits, money supply growth and foreign reserves, leaving to governments the choice of policies to achieve those targets. The Fund does not have the mandate, leverage, or expertise to dictate macroeconomic policy choices such as levels and patterns of social spending and taxes, investment priorities, or private sector policies. These decisions reflect the most fundamental political priorities of sovereign governments. Nevertheless, within these parameters the IMF has a clear orientation in the advice it gives governments toward reliance on market oriented economic measures. I strongly endorse this general approach which translates into fundamental support for private sectors, decentralized decision making, use of price signals, and a whole array of policies which cumulatively act to open economies to market forces.

Senator Kasten: One of the reasons given by those, including former Treasury Secretary William Simon and Under Secretary Craig Roberts, who oppose an increase in the IMF quota, is that it provides an incentive to stoke the inflationary fires once more.

In his Wall Street Journal piece of April 6, Mr. Simon wrote:

"The deeper the IMF, the banks, the State Department, the

Treasury, the Federal Reserve, Congress and the White House get involved in building a mountain of debt, the greater the stake they all acquire in the resurgence of world inflation."

Now, consider this from an excellent article entitled "Deflation and Global Debt" in the November 1, 1982 issue of Grand Strategy:

"On August 16, 1982, the United States sent Mexico \$1 billion in emergency funds. A series of meetings of international bankers was convened throughout the week of August 16-20. The purpose of those meetings was to construct a rescue package for Mexico. They were held in the offices of the New York branch of the Federal Reserve Bank of the United States, underscoring the fact that, from the first moment, the rescue of Mexico has been conducted with the feverish assistance of the United States.

Indeed, the monetary policy of the United States seems to have been considerably affected by the Mexican collapse. While the meetings were underway at the Federal Reserve, a remarkable week began elsewhere on Manhattan, over on Wall Street. Everywhere, the financial news was bad, but the New York Stock Exchange managed to achieve the sharpest weekly rise in its history, and on record volume of shares traded. Analysts reported that the Federal Reserve had at last been frightened into doing what it had steadfastly refused to do. It began to pump reserves freely into the banks, many of which were seriously at risk in Mexico. Upon this news, interest rates began to fall, and the stock market zoomed. Money growth has since continued upward, despite the fact that it is beyond the Federal Reserve's upper target range. We have the curious situation that most of the economic news is bad, some of it is extremely bad, and yet the world's largest stock exchange is setting records.

If the United States is compelled to abandon its fight against inflation, Mexico will have the honor of being among the efficient causes.

What is your reaction to this view?

Secretary Regan: The argument that IMF financing merely adds to a nation's debt levels entirely misses the purpose and impact of IMF financial operations. The key difference between IMF and other forms of financing is the policy conditionality associated with use of IMF resources, which requires borrowers to adopt economic adjustment programs designed to reduce their borrowing needs, restore their creditworthiness and establish the basis for sustained non-inflationary growth. In the end, borrowers have no alternative but to adjust, with or without IMF financing. The key issue is the speed and orderliness of the adjustment. With IMF financing, and the private and official resources that usually accompany an IMF program, the adjustment can be orderly, and the Fund's policy conditionality can help assure that it is effective. Absent IMF support, a country experiencing severe balance of payments problems could be forced to adopt excessive economic and financial contraction and disruptive trade and payments restrictions reminiscent of the Depression. The costs to the U.S. would be enormous in terms of the jobs of millions of Americans, the health of our banking system, and the prospects for sustained U.S. and world economic recovery.

The claim that increased U.S. participation in the IMF would help create a vested U.S. interest in the resurgence of inflation is difficult to comprehend. The IMF's policy conditionality is designed to reduce inflationary pressures by requiring borrowers to adopt policies that will restore a better balance in their domestic economies and thus establish sustainable external positions. The suggestion that this Administration -- which has brought about the most dramatic reduction in inflation in memory -- would seek renewed inflationary pressures simply does not hold water.

The Federal Reserve Board is responsible for the conduct of U.S. monetary policy and is better placed to respond to the article in Grand Strategy. It is our understanding that they view a sharp fall in the velocity of money plus significant changes in banking regulations as largely responsible for the increases in some measures of money supply recorded during the last half of 1982.

Senator Kasten: Can you tell me the amount of money that American banks have loaned to communist countries?

Do you believe it is substantial?

Do you see some irony in American banks loaning money to communist nations when we were recently putting pressure on our European allies not to aid the USSR in the construction of the Siberian pipeline?

Secretary Regan: The latest Country Exposure Lending Survey compiled by the bank regulatory agencies shows U.S. banks' claims outstanding as of mid-1982, adjusted for guarantees, to be:

	<u>\$ millions</u>
Bulgaria	233.6
Czechoslovakia	194.9
G.D.R.	900.7
Hungary	887.1
Poland	1,120.5
Romania	247.7
USSR	362.1
Yugoslavia	2,449.7
Subtotal	<u>6,396.7</u>
China (PRC)	789.3
Total	<u>7,186.0</u>

The aggregate amount is fairly substantial, although less than equivalent exposure in Mexico (\$25 billion) and Brazil (\$21 billion), and roughly equal to exposure in Argentina (\$8.8 billion).

We have objected to practices in a number of Western countries which result in officially-subsidized lending to the USSR and other Eastern European countries. We have not objected to ordinary commercial transactions. Those credits of U.S. banks extended under U.S.G. guarantee programs carry commercial rates. In recent years, the exposure of U.S. banks in Eastern Europe has been declining.

Senator Kasten: In the February 15, 1982 issue of Grand Strategy there appeared a brilliant analysis entitled: "Polish Debt: The Economic Strategy of an Empire." The thrust of this article is that there is a deliberate communist policy associated with Eastern bloc borrowing from Western banks and nations.

The article reads, in part:

"We must, therefore, take into account the possibility that the accumulation of this huge debt has been an act of policy by the communist states. And once it is considered in that light, as a deliberate act, and not the result of accident, or bumbling and folly on the part of the borrowers, the phenomenon takes on a different aspect..."

"In order to evaluate this argument, one must remember that until the Poles actually repay the loans, the food they have consumed and the capital they have imported is not expensive to them at all. It is incredibly cheap. The spanking new Polish steel mill may not be an efficient and wise investment by our standards, but it is a large and modern steel mill, and so far someone else has paid for it. The Poles will have been proved foolish if and when the day of reckoning comes, but not before. That day is not yet upon us..."

"If Poland should find itself unable to obtain new funds, there are always the other Warsaw Pact nations. There is Hungary -- with an economy that is thought to be the wonder of the East, and with membership in the IMF almost within its grasp. Hungary could put together a run on Western banks and governments of several years duration. Hungary could be compelled, as easily as Poland has been compelled, to spread the profits among its friends. There is also East Germany, whose claim upon the sympathies of West Germany is a potential asset of considerable value. There is Czechoslovakia, whose debt to the West is \$4.8 billion and rising -- a considerable sum, but not excessive by today's standards..."

What is your assessment of this argument?

Secretary Regan: There is no evidence to support the notion of a deliberate policy associated with overall Eastern bloc borrowing from the West. Nor is there any evidence that funds borrowed by one bloc country have been shared with others. The reverse is more true. Bloc countries have borrowed, then faced their debt problem individually, with little apparent sense of shared interest or concern for each other. The general lack of an East bloc response -- apart from the Soviets -- to Polish pleas for economic assistance these past two years tends to refute these arguments.

With the exception of Poland and Romania in 1981 and 1982, all Soviet bloc countries are meeting their debt service obligations as scheduled. During the past two years debt service obligations were maintained at considerable cost to the East bloc debtor countries despite sharp cutbacks in Western lending. Domestic consumption and investment were reduced to enable these countries to reduce hard currency imports and to free up goods for export to the West. Even Poland, the country with the most severe economic problems in the group, is current in its debt service obligations to Western banks under the terms of their 1981 and 1982 rescheduling agreements. If there were a deliberate policy as the article asserts, it is doubtful that these countries would make such efforts in light of the virtual cutoff in new Western lending to them.

SENATOR KASTEN: Mr. Secretary, the external debt of developing countries totals in excess of \$550 billion, two-thirds of which is owed to American banks. The argument is that a series of defaults on a debt this large could disrupt the entire world financial system, and, if this happened, some the largest

American banks would be in considerable economic difficulty, inevitably leading to a major impact on the U.S. economy.

If you accept this argument, could you give us some figures to go along with the argument -- what in statistical terms would happen to those banks and to the economy?

SECRETARY REGAN: The figure cited represents the approximate level of total LDC debt. The portion owed to private banks (some of which is guaranteed by creditor governments) is around \$275 billion, of which a little more than one-third is owed to U.S. banks.

A total loss on this debt would have a catastrophic impact on the solvency of the largest U.S. and other Western banks. But a total loss is a most unlikely event. A failure to manage the existing debt difficulties would, however, result in some further increase in loss of interest income and in the need to establish loan loss provisions.

For illustrative purposes, let us assume that for a period of one year Mexico pays no interest on loans from U.S. banks and that the banks' judgment as to the impairment of their loans induces them to make loan loss provisions equal to 20 percent of exposure. For the nine largest U.S. banks as a group, the reduction in after-tax earnings would be about \$750 million (roughly one-fourth of estimated 1983 earnings) as a result of the added loan loss provisions. (Certain assumptions are necessary as to interest rates charged and marginal tax rates.)

Such a scenario would clearly induce these banks to reduce lending domestically and abroad. To some extent their intermediary role could be carried out by other banks and through non-bank channels, but at a minimum cost of credit to domestic borrowers would rise, impairing the recovery.

SENATOR KASTEN: A frequent argument used to justify the IMF quota is that it is necessary to ensure that debtor nations can buy our exports. Our total exports to the five biggest borrowers, Mexico, Brazil, Argentina, Chile and Venezuela, amounted to about \$25 billion in 1981 and \$16 billion in 1982. In other words, our exports have already fallen \$9 billion.

How much further do you think they will fall? To zero? Isn't a further fall rather unlikely, and if so, how can this argument be used as a justification for increasing our IMF quota?

SECRETARY REGAN: For those five countries as a group, we are projecting that their total imports will fall about 7 percent in 1983 compared to 1982. This implies a further drop in U.S. exports to these countries of \$1-1.5 billion.

At the same time, four of these countries are scheduled to draw \$5.3 billion from the IMF during 1983. (Venezuela has no IMF arrangement at the present time.) If IMF financing had not been available, these countries would have been forced to cut imports by an equivalent amount, other things equal. Since the U.S. supplies about 40% of their imports, the potential loss of

U.S. exports would come to an additional \$2 billion. Actually, without the IMF, the impact would probably be substantially greater since the IMF's programs serve as a catalyst for larger amounts of financing from other sources.

Senator Kasten: We have heard many suggestions that without an increase in the IMF quota, a default by a debtor nation could cause the collapse of the entire banking system. But if the Federal Reserve carries out its responsibility as a lender of last resort, is any such collapse really likely?

In addition, according to an internal report on the potential threats to stability of the financial system from debt difficulties issued by the Treasury and the Federal Reserve last July, "In almost all cases, it is likely that a borrowing country's debt servicing difficulties will ultimately be worked out, most probably with no actual loss to the bank (other than opportunity costs) and possibly even a gain...."

The report continues:

"In today's environment, it is unlikely that there would be a generalized run on banks -- cash is not an alternative to bank deposits. That is, liquidity would stay in the system but would be concentrated in banks perceived as sound."

If this was the opinion of your own office of international banking last year when the so called "debt crisis" was considerably worse than today, why are you still using the nightmare argument now?

Secretary Regan: Major defaults would probably cause serious disruption, but "collapse" of the banking system is an extreme and unlikely consequence, and I have not used the term. There have been and will continue to be debt restructurings and reschedulings, worked out among borrowers and lenders. The debtors have a strong self-interest in working out a solution. That is not to say that U.S. banks would not suffer, at least temporarily, as a result of a disruptive adjustment process forced by the lack of adequate financing. Provisions for loan losses would increase, and there would be a diminished readiness to lend -- domestically as well as internationally -- leading to upward pressure on interest rates.

At the same time, a failure to obtain an increase in IMF resources would be likely to force a highly disruptive adjustment on borrowers, leading to severe reduction of their imports, and consequent impairment of economic recovery in the United States and other industrial countries.

Senator Kasten: Isn't your argument now reduced to the one used by Paul Volcker, as reported in the Wall Street Journal of April 29th? In response to the argument that the apparent worldwide economic recovery has lessened the need for the added U.S. contribution to the IMF, he replied that the increase is a necessary "insurance policy."

With a price tag of \$8.4 billion, isn't this a rather expensive insurance policy?

Secretary Regan: As I indicated in my statement to the Subcommittee on May 17, the debt crisis is not over. If the situation seems to have eased, that is in large part because a cooperative international effort to deal with it -- centered on the IMF and the agreed increase in its resources -- has been launched and is beginning to show positive results. We cannot now gut that strategy and expect anything but disruptive and damaging results.

Although an appropriation of \$8.5 billion is being requested, this amount does not reflect the real economic costs to the U.S. of its participation in the proposed increase in IMF resources. U.S. transactions with the IMF do not affect net budget outlays or the Federal budget deficit. The budget is affected by the net costs or gains resulting from financing these transfers and from exchange gains and losses due to changes in the dollar value of our SDR denominated reserve position in the IMF. From the beginning of FY 1970 to the end of calendar 1982, it is estimated that the annual average net budget cost to the United States of participation in the IMF amounted to about \$107 million annually.

Transfers to and from the IMF do affect the Treasury's cash position and borrowing requirements, and thus the domestic money and capital markets. Although a precise projection of U.S. cash transfers to and from the IMF or the impact on U.S. financial markets is impossible, the amount of increased Treasury borrowing, and thus its economic impact, is likely to be quite limited, because any drawdown on the U.S. quota will be stretched out over time. We project additional Treasury borrowing requirements amounting to about \$1 - 1.5 billion annually over FY 1984-87. This compares with net new Treasury requirements in FY 1984 in excess of \$200 billion, and total outstanding U.S. debt of \$1.2 trillion as of April 30, 1983. These relatively modest costs of the proposed increase in IMF resources must be weighed against the widespread costs to American jobs, exports, our banking system, and economic recovery of a failure to cope with current world economic difficulties.

Senator Kasten: Do you believe that the IMF is functioning as its founders at Bretton Woods intended -- as a means of stabilizing the world's monetary system?

Secretary Regan: Yes. The IMF has established in the early post-war period to help assure development of an open and cooperative international trade and payments system; and to prevent a recurrence of the widespread recourse to damaging domestic policies, restrictive trade and payments measures and predatory exchange rate practices that had contributed to the conditions leading to the outbreak of World War II. The IMF had demonstrated remarkable success in its efforts over the years in encouraging international transactions, and a vigorously expanding world economy.

The world has changed substantially since the mid-1940's, and the par value exchange rate system conceived at Bretton Woods no longer exists. However, the IMF has adapted to new circumstances. It serves as the central international monetary institution for its 146 member countries, with responsibility for:

- overseeing the operation and evolution of the international monetary system and providing the framework for international monetary relations;

- providing temporary balance of payments financing in support of members' efforts to implement effective and internationally responsible economic adjustment programs; and
- when needed, supplementing global liquidity through the creation (allocation) of an international reserve asset, the Special Drawing Right.

Today the IMF is at the center of the U.S. strategy for dealing with widespread debt problems. While the international monetary system has not worked perfectly since the mid-1940's, it has functioned well enough to permit a remarkable expansion in world trade and economic growth. The IMF shares in the credit for this.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

Senator Hatfield: One of the key elements cited in the Administration's strategy for resolving the international financial problem is the availability of official balance of payments financing. This current proposal increases the IMF quotas by 47% in attempting to address this problem. My concerns are whether this will be sufficient and whether the approach taken by the Administration and IMF to address the problem is realistic.

Current quota resources stand at 7 billion SDR's and recent newspaper articles cite both Venezuela and Brazil as possibilities for IMF financing assistance in the near future. Is the current availability of quotas sufficient to meet that demand?

Secretary Regan: It is estimated that the IMF's current uncommitted usable resources amount to about SDR 7 billion. These projections include the existing Brazil commitment -- Venezuela is discussing the possibility of obtaining IMF financing but no decisions have been made by the Fund on a request. Projecting demands for IMF resources is difficult; it depends importantly on members' balance of payments positions and financing needs; the availability of alternative sources of funds; the strength of IMF "conditionality" associated with use of IMF resources; and members' willingness and ability to implement IMF policy conditions. Subject to these uncertainties, however, we project that the IMF will be unable to make new financial commitments by end of the year. Thus the proposed increase in IMF resources is crucial to maintaining the IMF's ability to support adjustment efforts during a period of continuing strain in the world economy.

We believe the proposed increase in IMF resources to be realistic and appropriate. The dual approach we have developed -- a general quota increase combined with expansion of the General Arrangements to Borrow (GAB) -- will help ensure that the IMF has sufficient resources to fulfill its important responsibilities for promoting the stable financial framework required for world trade to prosper. The quota increase is expected to position the IMF to meet members' needs for temporary financing in normal circumstances. The contingency financing available through the GAB on a stand-by

basis will enable the IMF to respond quickly and effectively to situations which threaten the stability of the international monetary system.

Senator Hatfield: There are also reports that Mexico, Nigeria and France may be approaching the IMF for balance of payments assistance this year. Clearly current resources are inadequate. What impact would these nations have on the IMF quota resources?

Secretary Regan: Mexico already has a \$3.9 billion three year IMF program. It is difficult to comment on the impact on the IMF's financial position of possible drawings by Nigeria or France. The effect would depend on the size of the request, the phasing and maturity of the program, and the amount of quota and borrowed resources that would be drawn. Moreover the IMF could activate the existing GAB to finance a portion of a French drawing. However, under current IMF rules, Nigeria could obtain up to SDR 2.4 billion and France could draw up to SDR 13 billion. Clearly, financing requests of this magnitude would be difficult for the IMF to meet without the agreed increase in IMF resources.

SENATOR HATFIELD: Given the status of the world economy, do you anticipate that Mexico, Brazil and Argentina will be in a position to repay interest on outstanding loans in the next two years? What time frame do you expect these countries to be in a position to repay principal.

SECRETARY REGAN: Admittedly all three countries are now in arrears on some interest payments. However, we expect Mexico, Brazil and Argentina to pay interest on outstanding loans in the future, albeit with some difficulty. All three continue to make every effort to stay current on interest payments on foreign debt.

Brazil has already rescheduled \$4.5 billion of private and public medium and long-term principal payments owed to commercial banks this year. Mexico is close to completing the rescheduling of \$20 billion in public sector principal payments due from August 23, 1982 through December 31, 1984. Argentina is in the process of negotiating the rescheduling of about \$7 billion in short, medium and long term principal payments on public sector direct or guaranteed debt coming due this year. Of the three, only Mexico at this time rescheduled 1984 maturities.

In all three countries it is anticipated that economic adjustment programs will reduce future financing requirements, restore creditor confidence and improve access to international private financial markets. This, in turn, will minimize the risk of future accumulation of arrears on both principal and interest payments.

Senator Hatfield: I would like to draw an analogy now between domestic economic problems and those of an international nature. During the course of the recent recession there has been much discussion about assisting specific industries (i.e., timber, steel, autos, etc.). In each instance, though, the Administration has insisted that overall economic recovery is what those industries need.

The IMF, by the nature of the institution, has been addressing the problems of Mexico, Brazil and Argentina on an individual basis with U.S. support. Do you see any relationship between the overall world economy and economic problems in Brazil, Argentina, Mexico, etc?

Are the programs prescribed by the IMF then truly addressing fundamental world economic problems or are they attacking these problems on a piecemeal basis?

If not, what can the U.S. do to focus concern on this matter?

Would these problems be an appropriate subject of concern at the upcoming summit in Williamsburg?

Does the U.S. have any proposals to address these problems at that summit?

Secretary Regan: The world recession undoubtedly contributed importantly to the economic and financial problems of many LDCs through reductions in their commodity prices and export earnings, and thus their ability to pay for needed imports and service debt. However, current debt problems reflect the fact that many developing countries failed to adjust adequately to changing economic circumstances and to restore the sound domestic economic base needed for sustained growth and development. The comprehensive strategy being followed to deal with the debt problem emphasizes effective adjustment efforts by countries experiencing payments difficulties; adequate official financing, especially from the IMF, to support these efforts; prudent commercial bank lending to adjusting countries; emergency "bridge" financing by governments and central banks in lending countries, in exceptional cases of system-wide danger; and pursuit of non-inflationary growth while avoiding protectionism in industrial countries.

Clearly, the IMF must play a central role in this strategy. The financing provided by the IMF, as well as the private and official financing for which an IMF program serves as a catalyst, can help ensure that the adjustment by countries experiencing problems is orderly, and IMF conditionality can assure that it is effective. Adjustment in LDCs is a necessary but not sufficient condition to guarantee smooth resolution to current problems; hence our emphasis on non-inflationary growth in industrial countries and efforts to counter protectionism so that LDCs can increase their exports as overall recovery progresses.

The current economic and financial strains in the world economy are expected to be major topics at the Williamsburg Summit. The comprehensive international strategy which is being implemented, including the agreement to increase IMF resources to enable the Fund to play its central role, is strongly supported by other Summit countries. We believe that it is a realistic and effective means of dealing with current problems, and that emphasis needs to be placed on implementing its various elements fully.

Senator Hatfield: There are reports that countries like Nigeria, Venezuela, Peru, Nicaragua and El Salvador are discussing internally whether to pursue balance of payments financing from the IMF. What impact would these nations have on the resources of the IMF?

Secretary Regan: Both Peru and El Salvador currently have IMF programs in place. El Salvador's SDR 43 million stand-by arrangement is scheduled to expire in July of this year; Peru's SDR 650 million extended arrangement will expire in June 1985.

There has been press speculation about future arrangements with Nigeria and Venezuela is apparently seeking IMF financing. It is difficult, however, confidently to project the size or structure of any future IMF program or its impact on IMF resources. Nigeria's maximum access to IMF financing is 450 percent of its quota -- SDR 2.4 billion. Venezuela could potentially draw SDR 4.4 billion and Nicaragua SDR 230 million. Thus, maximum potential demand by these three countries, over a period of three years, could total SDR 7.0 billion. This would have a significant impact upon the IMF's current usable resources. IMF staff analysis of the potential financing needs of all member countries indicates that, absent the quota increase, its ability to enter into new commitments will be exhausted by year-end.

Senator Hatfield: Less developed nations are already discussing among themselves the need for additional quota resources after approval of this current request.

Given the number of nations looming on the horizon and contemplating approaching the IMF for balance of payments assistance, do you foresee the need for another quota increase in the near future? What would be the U.S. position on this request?

Secretary Regan: We believe that the proposed 47 percent increase in IMF quotas and expansion of the General Arrangements to Borrow will ensure that the IMF has adequate resources to address both normal and emergency financing needs through the next few years. Absent any unforeseen developments in the world economy, we do not believe another quota increase would be needed before completion of the Ninth General Review of Quotas, scheduled for 1988, and we are not prepared to consider acceleration of that review.

SENATOR HATFIELD: : A recent article in the Washington Post (May 13th) indicates that smaller banks have failed to give Brazil all the money promised in the lending package put together by the IMF. This same article implies that the major banks are growing weary of shouldering a "disproportionate" share of the burden. Have, in fact, some banks failed to provide the loans requested by the IMF? What can the U.S. or the IMF do about this?

SECRETARY REGAN : Brazil's 1983 financing program with commercial banks consists mainly of a series of "Projects." Project I, \$4.4 billion in medium-term syndicated loans, was signed in February with the first \$2.5 billion disbursed in early March. Project II, the agreement to relend \$4.7 billion in current maturities of medium and long-term obligations to banks, was signed at the same time. Project III, agreement to restore trade-related short-term finance to \$8.8 billion, has been confirmed by telexes from individual banks.

Project IV, the restoration of interbank deposits to their mid-1982 level of over \$9 billion, has also been agreed on a more informal basis. The failure of these deposits to reach the immediate target level of \$7.5 billion, much less the longer range target of a resto-

ration to the mid-1982 levels, is of serious concern. The Project IV interbank deposits are currently averaging about \$6 billion.

It has been primarily the smaller, regional banks in the United States and in Europe that have been most reluctant to restore their deposit levels with Brazilian agency banks. Performance, however, has varied sharply from bank-to-bank, country-to-country and over time.

The U.S. and the IMF are not in a position to force banks to change their lending decisions. The banks are well aware of the problem and are considering how best to make up the shortfalls represented in Project IV.

Senator Hatfield: Given the fact that the nine largest banks have 222% of their capital extended in outstanding loans, can the U.S. continue to expect these banks to lend?

Secretary Regan: As noted in my testimony, continued new bank lending in support of orderly and constructive adjustment programs is an essential element of our strategy to resolve debt and liquidity problems. Without a certain level of such lending, adjustment would be forced and disruptive, threatening to precipitate the very crises we are seeking to avoid.

The amount of net new lending need not be extensive. As Chairman Volcker indicated in his April 11 testimony before the Senate Committee on Banking, Housing and Urban Affairs, "in general, lending in conjunction with IMF programs can be extended without increasing the exposure of the banks in terms of ratios of their loans to capital or assets; in fact, these ratios should decline moderately."

QUESTIONS SUBMITTED BY SENATOR INOUE

Senator Inoue: Mr. Secretary: You have no doubt heard well-intentioned but, perhaps, not so well-informed critics of the IMF quota increase say it is a "bailout of the big banks".

How do you respond? Is it a bailout?

Is it true that private banks in the U.S. and abroad have charged Mexico some \$800 million as the price for "maintaining their lending relationships" with that country?

Are the banks not profiting from a rescheduling process that is, in effect, being underwritten by the IMF?

Secretary Regan: It is not a bailout. Private banks are not pulling out at the expense of the IMF or governments. They are continuing their involvement and providing net new lending to complement adjustment programs. To the extent that IMF-supported adjustment programs succeed in restoring external balance, the borrowing country will be in a better position to service its external debt. In that sense, banks as well as the international community generally will benefit from IMF involvement.

The figure of \$800 million does not appear to have any basis. The agreement reached with Mexico by private banks provides for a rescheduling fee of one percent on the rescheduled amount of \$20 billion -- or \$200 million. In addition, Mexico is paying commercial banks 1 3/4% -- \$87.5 million -- in front-end fees on the \$5 billion in new money being provided this year. Most of these amounts would represent an upward adjustment of yield (although direct expenses in such a rescheduling are very high); in general, it would be expected that a deterioration in the debt servicing capacity of a borrower should be reflected in a higher interest rate being charged. In accordance with proposals by the bank regulatory agencies -- and reflected in both House and Senate bills -- the portion of these fees representing yield adjustment should be taken into income gradually over the life of the loan rather than in toto when paid.

Senator Inouye: The statistics you have presented today show that the IMF has "only about 7 billion SDRs (Special Drawing Rights) available for new commitments." That is approximately \$7.7 billion.

What is the total foreign debt of non-OPEC developing countries at this same time?

How much of that debt, including interest, will come due this year?

How much of this amount is payments due will have to be refinanced? What is your projection?

Of the amount which will require refinancing, how much is expected to be covered by the private banks?

So, the amount to be financed by the IMF this year is...?

Secretary Regan: It is estimated that:

-- The total foreign debt (including short-term) of the non-OPEC developing countries at the end of 1982 was \$529 billion.

-- Interest payments on the entire stock of debt will amount to \$46 billion in 1983. Principal payments on medium and long-term debt will be \$47 billion, and \$78 billion of short-term debt must be replaced or restructured. Total debt payments (including short-term) will therefore be on the order of \$171 billion.

--Some \$25-30 billion of the total debt payments will not be paid according to the original schedules. About two-thirds will be rescheduled in arrangements already concluded or close to being finalized with commercial banks involving Argentina, Brazil, and Mexico. Most of the rest has been or is being rescheduled, but as much as \$1 billion will likely be in arrears at the end of 1983.

-- Private banks will provide 80-90% of the debt-relief that will be extended in 1983 to non-OPEC developing countries. Non-bank private lenders and governments will provide the rest. Multilateral institutions, including the IMF, by tradition do not provide debt relief.

-- The amount of debt relief cited above relates overwhelmingly

to principal payments. Rescheduling of interest payments may amount to less than \$500 million and involves mostly interest obligations to official lenders.

For a broader perspective, the gross required by non-OPEC developing countries in 1983 will be on the order of \$190 billion. This consists of \$78 billion of maturing short-term debt, \$47 billion of amortization payments on medium- and long-term debt, and \$65 billion to cover their aggregate current account deficit. (Interest payments of \$46 billion are a major component of the current account deficit.) The bulk of this financing -- some \$147-156 billion -- will come from the renewal of short-term credits, the disbursement of official grants, concessional loans and export credits, and the disbursement of official grants, concessional loans and private investment. Accumulated arrears will account for as much as \$1 billion and reserve drawdowns another \$1 billion. Finally, the IMF would provide some \$10-12 billion.

Senator Inouye: If my memory serves me correctly, it was as late as last September that members of your Administration were saying that no significant quota increase in the IMF was necessary. Now, the President has requested the urgent appropriation of \$8.5 billion to support increased U.S. participation in the IMF. What changes in the international economy prompted this about-face on the part of the Administration?

Secretary Regan: There has been no "about-face" in our approach to the IMF quota increase. The size of any quota increase represents the result of negotiations and compromise. In the quota negotiations -- which began early in 1981 -- many members of the IMF originally advocated a doubling or tripling of IMF quotas, increases that clearly would have been excessive. We, on the other hand, started from a position on the low side. The result was agreement on a quota increase of 47 percent and an expansion of the General Arrangements to Borrow, a package the Administration views as realistic and appropriate.

Senator Inouye: I would appreciate your clarification of the Administration's position regarding the appropriate role of government intervention in Third World economies.

Do you see a contradiction between (1) the Administration's determination (as expressed in the Treasury Department's assessment of U.S. participation in multilateral development banks) that Third World governments should remove themselves from pricing and production policies and allow the unfettered operation of the free market (2) the Administration's support for IMF conditionality, which often prescribes increased governmental involvement in the economies of Third World countries?

When the IMF agrees to provide adjustment assistance to a Third World country, does it not often require that country to take specific interventionist steps to carry out economic changes?

Do you see this "conditionality" as compatible with the Administration's views on the "magic of the market place"?

Secretary Regan: There is no contradiction between the Administration's support for market dynamics and IMF conditionality. It is totally mistaken to believe IMF conditionality increases governmental intervention in Third World economies. If anything, the IMF urges greater reliance on market forces.

Disbursement of IMF financing is normally linked to adherence to macroeconomic performance criteria such as the levels fiscal deficits, money supply growth and foreign reserves. The IMF does not have the mandate, leverage, or expertise to dictate the microeconomic policy choices needed to achieve those targets. These decisions on spending, taxes, investment priorities, role of the private sector, etc. are at the core of national sovereignty. Within these parameters, however, the advice the IMF gives countries reflects a clear proclivity toward market oriented economic measures. This translates into fundamental support for private sectors, decentralized decision making, use of price signals, and a whole array of policies which cumulatively act to open economies to market forces.

Senator Inouye: When the Senate last considered a proposed increase in the U.S. quota share of the IMF -- I refer, of course to the \$5.5 billion we provided on December 13, 1980 -- I was concerned that the quota increase, in the absence of any meaningful changes in IMF authorities, would have no lasting effect and would only enable the IMF to limp toward the next crisis.

Will there be any specific changes in IMF authorities associated with this proposed increase, or are we merely assuring that the international economy will continue to lurch from one crisis to the next?

Under the new quota, will the IMF's supervisory or regulatory powers be enhanced?

Will the IMF's ability to require structural changes in the economy of recipient countries -- as a condition for IMF assistance -- be diminished in any way?

What assurances can you give the Committee that in three years you or your successor will not find it necessary to request funding for yet another quota increase?

Is the size of the proposed quota increase sufficient to meet the requirement for increased liquidity? Is the size large enough to meet the current crisis?

Secretary Regan: The IMF does not have the mandate or power to compel countries to follow appropriate economic policies, nor can it prevent shocks to the system such as sharp energy price increases. It is not possible to provide assurances that there will be no international economic and financial crises in the future.

We do believe, however, that the comprehensive U.S. strategy described in my testimony offers the most realistic method of overcoming current world economic difficulties. The IMF is the centerpiece of that strategy because of the Fund's ability to promote effective balance of payments adjustment. IMF financial

arrangements conditioned on the implementation of sound economic policies help countries correct the underlying causes of their balance of payments problems. Moreover this adjustment can take place in a more rational and orderly manner, at higher levels of imports and economic activity, than would otherwise be possible. Because of the crucial need for adjustment, the United States strongly supports effective IMF conditionality. We believe that major IMF members and the management of the institution share this view and would resist efforts to weaken IMF conditionality.

The United States has consistently encouraged strengthening of the IMF's surveillance activities. To strengthen its ability to promote adjustment by identifying emerging balance of payments problems before they become severe, the IMF is expanding its efforts to collect, analyze and disseminate information on country debt. We strongly support this effort, and have urged the IMF to work closely with the World Bank and other institutions working in this field.

The proposed increase in IMF resources is an important step to strengthen the IMF's ability to promote adjustment. The dual approach we have developed -- a general quota increase combined with expansion of the General Arrangements to Borrow -- will help ensure that the IMF has sufficient resources both to address normal balance of payments financing requirements over the next few years and to meet emergencies that might arise. With implementation of the proposed resource increase, we do not believe further review of IMF resources will be necessary prior to the regular review scheduled for 1988.

Senator Inouye: Do you believe that the proposed quota increase will give the IMF the capacity to respond to precipitous changes in trade balances and balance of payments requirements -- to respond in a timely fashion and in a way which permits countries to adjust payments imbalances before they are caught by yet another disruptive change?

Secretary Regan: Yes. The dual approach we have developed -- a general quota increase combined with expansion of the General Arrangements to Borrow (GAB) -- will help ensure that the IMF has sufficient resources to fulfill its important responsibilities. The quota increase is expected to position the IMF to meet members' needs for temporary financing in normal circumstances. The contingency financing available through the GAB on a stand-by basis will enable the IMF to respond quickly and effectively to situations which threaten the stability of the international monetary system.

SENATOR INOUE: It has been reported that you are considering additional lending to Brazil. Are these reports accurate?

SECRETARY REGAN: We are following the Brazilian situation carefully, but have no plans for additional official lending at this time.

SENATOR INOUE: Is Brazil current on its payments to foreign lenders?

SECRETARY REGAN: No. As Brazilian officials have noted publicly, there are currently some \$800 million in past due payments. Some of these are due to Brazilian commercial banks which appear able to cover them through their own resources. Past due payments to external creditors are estimated to be in the range of \$500-600 million, with most past due payments being only 10-20 days overdue.

SENATOR INOUE: Is Brazil fulfilling the terms of its agreement with the IMF?

SECRETARY REGAN: The IMF is reviewing data submitted in accordance with the requirements of the Brazilian IMF program. A judgement is not possible until the IMF staff has had an opportunity to completely examine the facts and present its analysis to the IMF's Executive Board. This process is expected to take most of June.

SENATOR INOUE: If you were to reach a determination that it is in the interest of the United States to lend to Brazil, how would you make a loan? What would be the source of funds? What is the total available in this source? Would you have to seek Congressional approval for a loan to Brazil from this source?

SECRETARY REGAN: The primary responsibility for meeting Brazil's financing requirements lies with the private sector. If, nonetheless, we were to conclude that additional official financial assistance were needed and appropriate, we would adhere to the following principles:

- (1) Any loan would have to be made as an adjunct to and not a substitute for an appropriate level of private sector funding to Brazil. We should not and will not bail out banks.
- (2) Treasury resources are limited to short-term financing under the Exchange Stabilization Fund (ESF). Such loans would only be appropriate to meet a short-term liquidity problem and would have to have an assured source of repayment in the short term.

Brazil has fully repaid all previous credits made by the U.S. Treasury. As a result, the only remaining obligation is a \$500 million contingent liability with respect to Brazil's \$1.45 billion arrangement with the B.I.S. Brazil, of course, continues to enjoy normal access to EXIM Bank and CCC finance.

While the use of ESF resources does not require Congressional approval, the Treasury consults members of the appropriate committees concerning ESF financing and would, of course, do so with respect to further financing for Brazil.

SENATOR INOUE: If the United States helps Brazil get through the current liquidity crunch, will that be the end of it, or will Brazil require additional loans next year?

SECRETARY REGAN: Brazil's program of adjustment with the IMF is a

three-year program. Brazil clearly will require additional external finance in the years to come. We are hopeful, however, that with continued economic adjustment by Brazil and the consequent strengthening of Brazil's external position, the private financial markets will provide needed financing to Brazil in the years ahead.

Senator Inouye: Mr. Secretary: On page 6 of your statement, you raise the specter of broad-scale economic collapse, if the private commercial banks were "to pull back entirely from new lending this year."

Is it likely that banks will pull back entirely from new lending? Do they not, in fact, find it necessary to advance new lending to protect old loans?

There has been extensive public discussion lately of a "second wave" of defaults and delayed payments.

How probable is this second wave?

Will the proposed quota increase be sufficient to forestall further defaults?

Secretary Regan: My statement indicated that LDCs would have great difficulties adjusting to the consequences of zero net lending and that the impact of such a development on industrial countries' exports would be substantial and likely to undercut the recovery. However, I doubt that a standstill in net new lending will occur, in part for the reasons suggested in the question -- it is more likely that net new lending from banks will be on the same order of magnitude as the level of 1982, i.e., about \$20 billion.

Some countries that have worked out agreements with creditors and the IMF may encounter further problems, and additional countries will probably face debt servicing problems for the first time. Precise quantification is not possible, but any "new" countries will necessarily bring smaller scale problems, since the largest LDC debtors are among those that have already reached agreements. We are hopeful that any renewed problems on the part of these large debtors will involve smaller magnitudes than the initial ones and that relatively modest adjustments in economic programs and financing will suffice.

The proposed quota increase is one element of a comprehensive strategy. It is a crucial element and, together with the proposed expansion of the General Arrangements to Borrow, sufficient in terms of the IMF's role. But other elements must also work out satisfactorily in order to resolve international debt problems.

Senator Inouye: Under the terms of the proposed increases of the IMF quota and the General Arrangements to Borrow, is it possible for the United States to contribute less than the amounts requested by the President?

Would the IMF quota increase take effect, if the Congress were to appropriate, say, \$4 billion rather than the \$5.8 billion requested?

The U.S. currently has a quota share of 21.01 percent and a voting share of 19.88 percent, is that correct?

Because an 85 percent vote is necessary for quota changes and changes to the IMF Articles of Agreement, the U.S. currently has veto power on such changes, is that correct?

Under the terms of the proposed quota increase, what is the projected U.S. quota share and the projected U.S. voting share?

Would the U.S. lose its veto, if the Congress declined to appropriate the full amount requested by the President?

Secretary Regan: The IMF quota increase takes effect if and when members with 70 percent of current quotas formally consent to and subscribe their individual quota increases. Were the Congress to appropriate anything less than the requested SDR 5,310.8 million (approximately \$5.8 billion), the U.S. could not consent, under the terms of the Board of Governors resolution, to its quota increase. If a sufficient number of IMF members chose to go ahead without the U.S. subscription, a quota increase could go into effect. However, the increase in usable resources would not be adequate, and the IMF's ability to deal with current economic problems would be seriously undermined. Moreover, the U.S. voting power in the IMF would fall sharply to about 14.3 percent. However, it is quite possible that other major countries would refuse to consent to a quota increase without the United States, believing that our leadership role and economic position in the world requires U.S. participation. In that event, the IMF's ability to commit new financing would then cease by the end of 1983.

The current U.S. share of IMF quotas is 20.65 percent, and our voting share is 19.52 percent. This gives the United States a veto over major IMF decisions which require an 85 percent majority vote, such as IMF gold sales, SDR allocations, quota increases, and amendments to the Articles of Agreement. Under the proposed quota increase the U.S. quota and voting shares would decline modestly to 19.90 percent and 19.15 percent respectively, providing a reasonable margin above the 15 percent voting share necessary for veto power over major decisions. As indicated above, failure to enact the legislation and participate in the quota increase would result in the loss of the U.S. veto.

Senator Inouye: When is the IMF quota increase to take effect?

Is there a percentage "trigger" which will make the quota increase effective?

Is there a certain date by which the United States must subscribe, or else run the risk of an adverse quota change or a change in the charter taking place over our objection?

If the U.S. delays and does not provide for an increase in its quota share by a certain date, will it lose SDR allocations which would otherwise be available?

Why has the President requested this funding as a fiscal

year 1983 supplemental appropriation? Should it not be considered as part of the regular fiscal year 1984 appropriations bill?

Secretary Regan: Under the IMF Governors Resolution on the quota increase, each IMF member country has until November 30, 1983 to formally consent to its proposed increase. The increases become effective when consents have been received from members having not less than 70 percent of present quotas and these members have paid their increased subscriptions. If the United States had not consented to its quota increase by the time others' quota increases go into effect, the U.S. voting share would decline sharply. If all quotas were raised as proposed, with the exception of the United States, our voting share would fall from 19.5 percent to 14.3 percent. This would eliminate the U.S. veto over such major IMF decisions as quota increases, SDR allocations, sales of IMF gold, and amendments to the Articles of Agreement.

No allocations of SDR are presently planned. However, should the IMF decide to allocate SDRs before the U.S. had consented to its quota increase, the United States would forgo a significant portion of the SDR allocation.

The Administration is requesting an FY 1983 supplemental appropriation instead of a regular 1984 appropriation because of the need to increase IMF resources as soon as possible. Current IMF resources are being depleted at a rapid rate, and the Fund's ability to undertake new financial arrangements is projected to be exhausted by the end of the year. A supplemental 1983 appropriation was viewed as permitting earlier Congressional consideration, and enactment, of the IMF legislation.

Senator Inouye: On December 13, 1980, the Senate considered and passed H. J. Res. 601, providing for a \$5.5 billion increase in the U.S. quota share in the IMF.

The primary reason for a quota increase at that time -- as stated by then-Secretary of the Treasury, Mr. Miller -- was the "unrealistically low level" of the existing quota in relation to world trade.

What would happen to world trade if the proposed quota increase does not become effective? Would countries be likely to adopt restrictive trade policies in an effort to preserve the foreign exchange available to them?

Secretary Regan: Failure to increase the IMF's loanable resources would severely constrain its ability to provide the new financing necessary to promote orderly economic adjustment by the LDCs. A sharp cutback in Fund lending -- which would almost certainly be accompanied by a pullback by private banks -- would necessitate abrupt and painful adjustment in many LDCs. In particular, trade and current accounts would have to shift rapidly to reflect the new lower level of official and private financing and imports would be drastically reduced.

This abrupt trade account adjustment would come largely at the expense of the industrial countries. As a consequence of unavoidable cuts in LDC imports, industrial country exports would be directly reduced by \$35-40 billion. This would represent a direct

loss of 0.3 to 0.5 percent of GNP in the industrial countries; secondary effects could double that loss to some 0.6 to 1.0 percent of their GNP. At the early stage of global recovery, a drop of this magnitude from lost exports could abort the gradual rebuilding of consumer and investor confidence needed for a sustained recovery.

For the United States, the effects would be broadly similar. Growth could be about 1 percent less than we're expecting, and our trade deficit would grow very rapidly due to the loss of \$12 billion or so in exports to LDCs. Lost jobs in vital export sectors would compound the difficulty of our recovery efforts. Estimates indicate that for every \$1 billion decrease in U.S. exports we lose 24,000 jobs. This suggests that a \$12 billion decline in U.S. exports would produce a job loss of 300,000.

Some of the LDCs would probably respond to sharply reduced balance of payments financing with protectionist policies. Yet, as regards American jobs and demand for American exports, import reduction through abrupt adjustment is functionally equivalent to import reduction through protectionism. In either case, American business and American workers will themselves be subject to a painful and unnecessary economic adjustment.

Senator Inouye: On December 13, 1980, the Senate considered passed H. J. Res. 601, providing for a \$5.5 billion increase in the U.S. quota share in the IMF.

The primary reason for a quota increase at that time -- as stated by then-Secretary of the Treasury, Mr. Miller -- was the "unrealistically low level" of the existing quota in relation to world trade.

What is the present ratio of IMF quotas to world trade?

Secretary Regan: See attached table and graph:

IMF Quotas as Percentage of World Imports

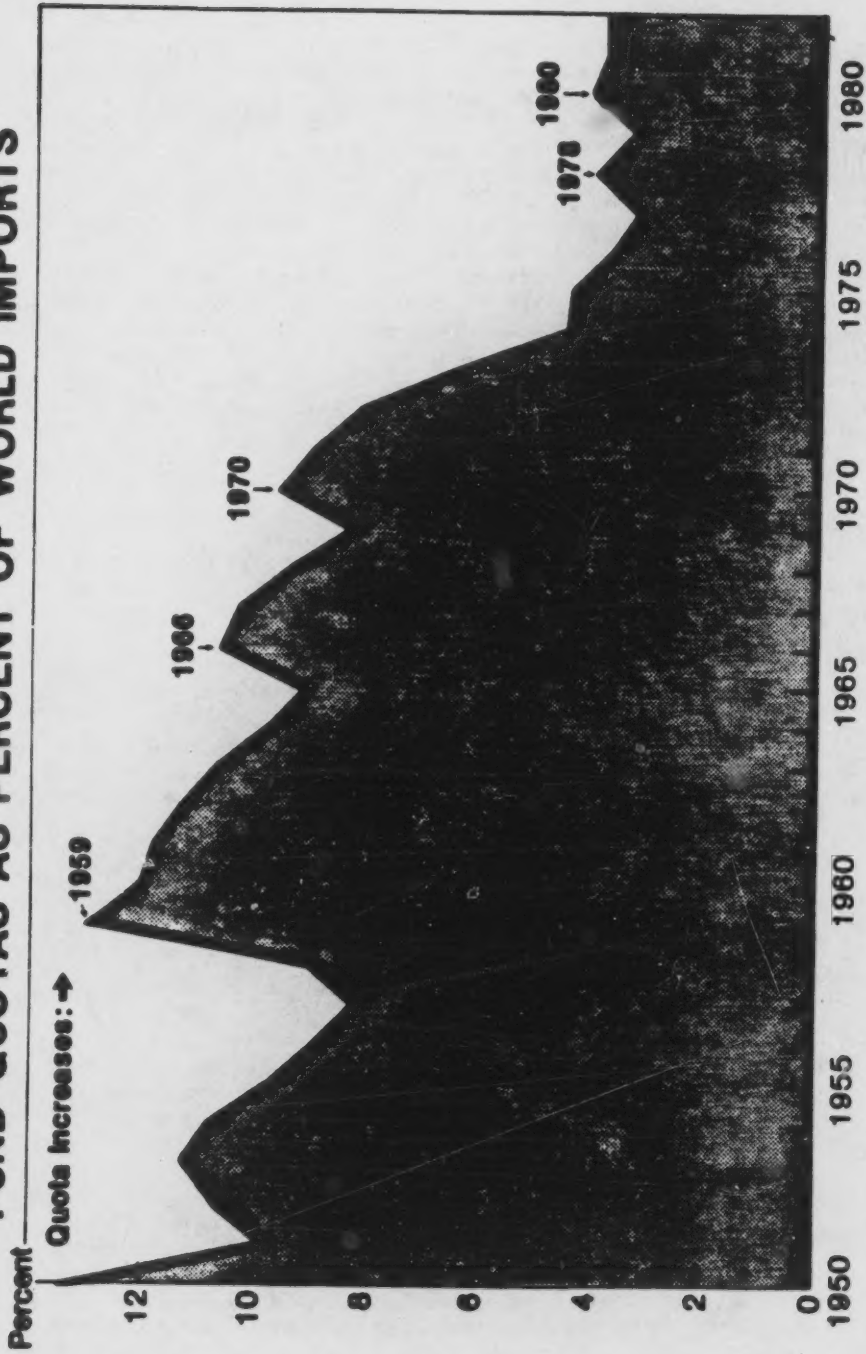
<u>Year</u>	<u>World Imports (\$ billion)</u>	<u>Quotas¹ (\$ billion)</u>	<u>Quotas as Percentage of Imports</u>
1950	59.30	8.73	14.7
1951	82.07	8.73	10.6
1952	80.83	8.73	10.8
1953	77.06	8.73	11.3
1954	80.28	8.73	10.8
1955	89.85	8.75	9.7
1956	99.19	8.93	9.0
1957	109.05	9.01	8.2
1958	101.76	9.19	9.0
1959	107.91	13.96	12.9
1960	121.00	14.74	12.2
1961	126.68	15.04	11.8
1962	133.77	15.18	11.3
1963	145.75	15.56	10.6
1964	163.16	15.85	9.7
1965	177.22	15.97	9.0
1966	194.96	20.65	10.6
1967	204.57	20.98	10.2
1968	227.50	21.19	9.3
1969	259.33	21.35	8.2
1970	298.43	28.43	9.5
1971	333.78	28.89	8.6
1972	391.48	31.66	8.1
1973	539.61	34.79	6.4
1974	790.47	35.10	4.4
1975	819.00	35.46	4.3
1976	920.04	33.73	3.6
1977	1066.82	34.11	3.2
1978	1237.98	48.84	3.9
1979	1559.78	50.41	3.2
1980	1923.36	77.56	4.0
1981	1907.40	71.54	3.7
1982	1785.33e	67.41	3.8
1983	1803.18p	99.04*	5.5

e estimated

p projected

* Assumes 47.5 percent quota increase and \$/SDR rate of \$1.10 =
SDR 1.00

FUND QUOTAS AS PERCENT OF WORLD IMPORTS



Senator Inouye: Many people mistakenly regard the IMF as a development assistance institution and, consequently, view U.S. participation in the IMF as "foreign aid." Can you explain why the proposed increase in the U.S. share of the IMF quota is not foreign aid?

Secretary Regan: The IMF is a unique institution, differing fundamentally from the multilateral development banks (e.g., the World Bank) or other foreign aid agencies. There is no set class or group of lenders or borrowers in the IMF, no concept of "donor" or "recipient". Each member is obligated to provide financing to the IMF for use in IMF drawings by other countries facing balance of payments needs; and each country in turn has a right to draw upon the IMF when it faces a balance of payments need. The U.S. subscription to IMF resources has been used (and repaid) many times over the years. In turn, the United States has drawn upon IMF resources on 24 occasions, for a total of \$6.5 billion, and is the second largest user of IMF resources.

The IMF differs from foreign aid agencies in several other important respects:

-- The assistance provided by the multilateral development banks is typically project specific; that is, the loans are specifically targeted for use in financing particular capital projects such as hydroelectric installations, roads and irrigation systems. IMF loans, on the other hand, are not tied to projects or infrastructure development but rather are for use in general balance of payments financing.

-- Additionally, while development loans are usually of long-term maturity, IMF financing is temporary, provided on a short to medium-term basis.

-- Finally, IMF financing may be distinguished from foreign aid by virtue of its conditionality requirements. The IMF is the only international institution which ties its loans to implementation by the borrowing country of a comprehensive program for macro-economic adjustment.

Senator Inouye: I'm sure you know that many people mistakenly regard the IMF as a development assistance institution and, consequently, view U.S. participation in the IMF as "Foreign Aid." Why do countries compete for increases in [IMF quota] shares? What are the advantages of increased shares?

Secretary Regan: As indicated in the answer to another question from the Committee, the IMF is a monetary institution not a foreign aid agency. Despite the fact that a higher quota share increases a member's required financial commitment to the IMF, there is substantial competition among members to raise individual quota shares. Higher quota shares provide members with several advantages which are generally considered to outweigh any costs associated with a higher quota subscription.

-- First, because access to IMF resources is based on individual countries' quotas, higher quotas provide members with greater potential access to IMF financing.

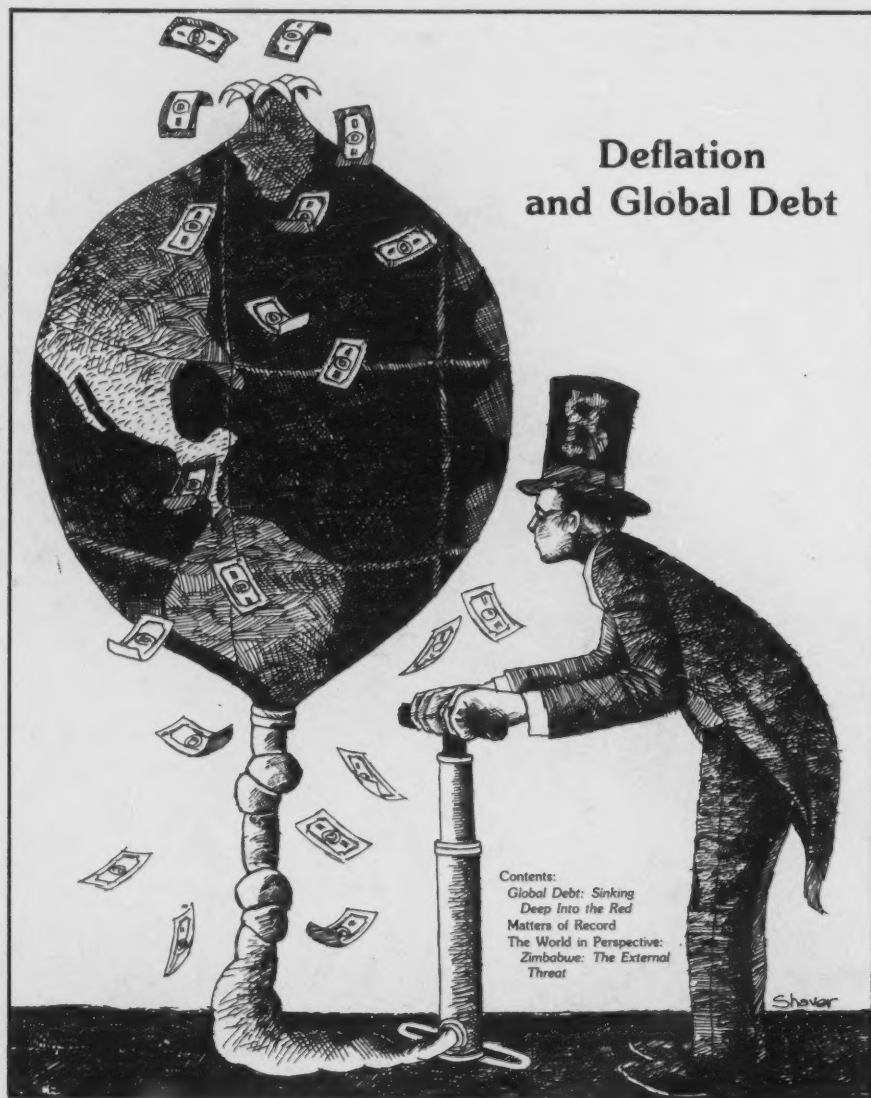
- Second, voting power is determined by quota shares. Each member receives 250 votes plus 1 vote per each SDR 100,000 of quota. (This is particularly important to the United States which is the only country possessing votes sufficient to veto any major IMF Executive Board decision. Failure to approve the U.S. quota increase would, if other countries' increases went into effect, eliminate the U.S. veto.)
- Finally, quota shares determine the distribution of SDR allocations to individual members.

GRAND STRATEGY

C O U N T E R C U R R E N T S

Vol. 2, No. 21

November 1, 1982



Global Debt: Sinking Deep into the Red

For almost two years now, an ominous whisper has been audible behind the general groaning of economic malaise. The talk of inflation and unemployment has, as usual, been loud. The talk of beleaguered industries and depressed areas has naturally persisted. Governments have fallen with that frequency normal in tough economic periods, and shifts of opinion from left to right and back again have recurred in many industrialized countries. All of this is not out of the ordinary during times of recession, and we have come to consider the difficulties irksome, tedious, disruptive — but somehow not surprising.

Lately, however, another element — an almost unprecedented element — has been added to our worries over hard times. There is doubt about the banking system, the massive modern banking system that is headquartered in a few of the very richest countries, and that sprawls all over the world. There is apprehension that the whole vast structure, connected as it is to the treasuries of the mightiest Western nations, may be unable to cope with the dangers it faces.

We had come to think that, however sharp recessions might become, they could never again achieve that bleakness that characterized the Great Depression. Governments had learned their lessons from that catastrophe. Correctives were now in place. Welfare, government deficits (or surpluses), and regulation of business had become powerful instruments to even out economic activity. In particular, regular surveillance of banking, and scientific management of currencies, would ensure that no sudden contraction could stymie trade and industry. There was insurance to protect depositors. There were government auditors to protect stockholders. Everything seemed secure.

Suddenly, however, we are in the presence of a new and ominous set of facts. Two years ago bankers were blithely lending money to Poland, and we allowed ourselves to believe that this was winning Poland away from her oppressors. Today Poland is miserably bankrupt, and miserably oppressed by Soviet henchmen, who are haughty and stubborn with our banking representatives.

Two years ago, our largest banks were lending freely to Third World countries, and we allowed ourselves to believe that we were finally rescuing them, or some of them, from poverty. Today, Mexico has collapsed, and Argentina and Brazil are close behind, and others may be close behind them.

Two years ago, there had been no Penn Square bank, no Lombard Wall, no Drysdale Securities. Two years ago, in short, there was no liquidity crisis. Now we have what we have not had since the early 1930s. It carries profound implications for international relations.

To some extent, this situation became public knowledge during the Polish crisis. Now its depth and breadth are being manifested by events elsewhere. Attention has recently been diverted from the East Bloc debts by what is happening in Latin America, and in particular in Mexico. During the month of August, Mexico suffered an economic collapse.

The Collapse of Mexico

The events that led to this collapse had begun more than a year earlier. During the summer of 1981, Mexico was compelled by slack demand to cut its oil prices by \$4 per barrel. Mexico's inflation was already 30 percent, and her interest rates more than 40 percent. Her bankers were casting about the world trying to borrow \$18 billion net in a single year, which eventually they managed to do. Despite oil exports, Mexico's current account was \$11.5 billion in deficit in 1981. It was plain that Mexico was sick, and getting sicker.

The peso began to weaken in 1980; in 1982 it crumbled. In February of this year, there was a devaluation of 30 percent when the Bank of Mexico exhausted its ability to support the currency. Within a month, the peso was again tottering, and fell another 15 percent. Meanwhile, Mexican bankers were trying to borrow \$30 billion in a single year, a height to which the ambition even of the Poles has not aspired. In June, Mexico received a \$2.5 billion rescheduling on certain notes immediately due; still, her reserves had fallen by \$1 billion since the beginning of the year. Mexico's huge conglomerate,

Grand Strategy: Countercurrents (Second-class Permit pending, Claremont, CA 91711; ISSN 0277-3163) is published semi-monthly on the 1st and 15th, except mid-December, for \$35/year personal; \$50/year institutional; \$50/year overseas (back issues \$2.25 each) by Public Research Syndicated, 480 N. Indian Hill Blvd., Suite 2, Claremont, California 91711.

Application to Mail at Second-class Postage Rates is pending at Claremont, California.

POSTMASTER: Send address changes to *Grand Strategy: Countercurrents*, 480 N. Indian Hill Blvd., Suite 2, Claremont, California 91711.

Grupo Alfa, had stopped paying the principal on its debt and was paying very little interest.

During the second week of August, Mexico took a series of radical measures designed to prevent bankruptcy. Foreign exchange markets were closed. The peso was allowed to float. The people were encouraged and threatened not to convert currency, and to bring home money they had prudently placed on deposit abroad.

These measures failed. If bankruptcy means the inability to meet immediate obligations, or to raise the funds to meet them, Mexico was by mid-August bankrupt. On August 16, the United States sent Mexico \$1 billion in emergency funds. A series of meetings of international bankers was convened throughout the week of August 16-20. The purpose of those meetings was to construct a rescue package for Mexico. They were held in the offices of the New York branch of the Federal Reserve Bank of the United States, underscoring the fact that, from the first moment, the rescue of Mexico has been conducted with the feverish assistance of the United States.

Indeed, the monetary policy of the United States seems to have been considerably affected by the Mexican collapse. While the meetings were underway at the Federal Reserve, a remarkable week began elsewhere on Manhattan, over on Wall Street. Everywhere, the financial news was bad, but the New York Stock Exchange managed to achieve the sharpest weekly rise in its history, and on record volume of shares traded. Analysts reported that the Federal Reserve had at last been frightened into doing what it had steadfastly refused to do. It began to pump reserves freely into the banks, many of which were seriously at risk in Mexico. Upon this news, interest rates began to fall, and the stock market zoomed. Money growth has since continued upward, despite the fact that it is beyond the Federal Reserve's upper target range. We have the curious situation that most of the economic news is bad, some of it is extremely bad, and yet the world's largest stock exchange is setting records.

If the United States is compelled to abandon its fight against inflation, Mexico will have the honor of being among the efficient causes. But that is not all. Mexico has also managed to cause a great deal of turmoil in the International Monetary Fund.

Mexico's appeal for help will not, if custom holds, be answered unless the International Monetary Fund certifies that she is taking steps to help herself. The steps prescribed by the IMF are seldom welcome to the distressed, or transgressing, nation. They may be characterized as a demand that the nation live within its means, pay off its debts punctually in the future, and make the payments in a currency that is stable.

These prescriptions from the IMF are always resented; they are seldom resisted successfully.

However, the IMF has never before had such burdens to bear. At the Toronto meeting of the IMF in early September, the members were divided as to how best to cope with the increasing number of debtors pressing at its door. The majority wished to increase the resources of the Fund by a factor of 1.5 or 2. The United States wished to keep the resources of the Fund relatively low (if Brazil, Argentina, and Mexico all come to the Fund for help in the next twelve months, its resources could conceivably be exhausted). Emergencies, in the American view, should be met with a special contingency fund that would be used only in extraordinary circumstances.

These two positions reflect the two, somewhat contradictory, purposes of the IMF. It must, on the one hand, reassure the lending institutions that the world's financial system is backed up by reserves that will prevent massive default. It must, on the other hand, convince the world's debtors that they have no choice but to place their affairs in order. If it is too tight with its funds, the creditors may panic, cease lending to countries like Mexico or Poland, and cause a series of defaults. If the Fund is too loose, the Polands of the world will depend on the Fund as a regular source of credit. Its position as enforcer would then be compromised.

There is reason to apprehend — as the policy of the United States seems to apprehend — that the ability of the Fund to enforce orderly finance is deteriorating. In Latin America, where the debts are highest, the power of the debtors is potentially very large, as is the attraction of default. Poland's debts are impressive at \$25 to \$30 billion; Mexico owes between \$80 and \$90 billion, more than the entire debt of the Warsaw Pact; Brazil, which has no oil of its own, owes between \$80 and \$90 billion; Argentina, which has no oil of its own, owes between \$35 and \$40 billion. Here we have, then, three nations in similar economic difficulties, whose foreign debt totals more than \$200 billion. This is more than 35 percent of the total foreign debt of the Third World. Latin America as a whole owes more than 40 percent of the total foreign debt, and 60 percent of the total foreign debt owed to banks.

The Genesis of the Problem

It is not, on the face of it, an undesirable thing for lesser developed countries (LDC) to be net importers of capital. For more than half of its life, the United States has been a net debtor. Borrowing is necessary for capital growth. However, borrowing must be founded upon a pool of investment and capital. If, hand in hand with

the growth of debt, there is a growing productive capacity, that is a sign that the borrowed resources are being effectively employed. That is a sign that the borrowed funds, even steadily increasing borrowed funds, can be repaid.

This is not, however, the way in which finance has been managed in Latin America and in much of the Third World. The massive debts began to grow after the Arab oil embargo of 1973-74. After the great rise in oil prices, the world's economy was thrown into disarray for several months. It was discovered pretty soon, however, that the largest industrial nations were strong enough to weather the storm. It was in the non-oil producing, lesser developed countries that the severest damage was done.

There was another problem, too. The oil-producing nations suddenly found themselves with a vast revenue flowing in. They were in no way equipped to handle it. They had no place to spend the funds. They could not consume what they could afford to buy. It was necessary for them to invest the larger portion of their income. But where to invest? That was the question.

Secretary of State Kissinger was prominent among those who supplied an answer. The answer was called "recycling." The OPEC nations would continue to charge high prices, prices that many of their customers were simply unable to pay. OPEC nations would then deposit their revenues in Western banks. Western banks would then lend the money to poor countries. Poor countries would use the money to pay their oil bills, and the circle would be complete. It was a clever way to keep up the demand for oil in the face of drastically higher prices. It was a tremendous feat of finance.

There was, of course, a weak link. Poor countries were borrowing funds, not in order to finance growth, but in order to balance their current accounts. Let it be noted that this was precisely the same thing that the Warsaw Pact nations were doing, and at about the same time. What, for example, did Poland do with the money it borrowed? Principally, it did two things: (1) it financed certain capital development projects, almost none of which yield any significant amount of exportable goods, but some of which have some interesting military implications, both potential and actual; and (2) it bought wheat and other consumables from the West, which it used for a few years to keep its population quiet.

Borrowing funds to meet one's current obligations, when there is no definite prospect of generating sufficient revenue to bring the current account into balance, is a highly questionable financial practice. Still, it can be continued for a while, and under certain conditions it can be continued for a long while. Especially can it be continued for a long while if there is

inflation. When there is inflation, all one need do is try to meet his interest payments; inflation can be relied upon to retire the principal without any assistance from the debtor.

Moreover, when there is inflation there is a lot of money available to be borrowed. During the 1970s, international lending grew rapidly both in absolute terms and as a percentage of lending as a whole. Bank syndicates began to prowls the globe, looking for nations willing to borrow. Lenders, like borrowers, learn pretty quickly that in inflationary times one must adjust one's strategy, one must move quickly, one must do a large volume in a short time, one must hustle if one is to make money. How potent a factor inflation is over bankers' attitudes is revealed, for example, in Chase Manhattan's part in the Drysdale and the Penn Square episodes. In both cases, loans were being made after perfunctory or insufficient investigations, and the lending officers were receiving bonuses for high volume. That, in part, accounts for the tremendous rise in loans to lesser developed countries and to Warsaw Pact nations. Until very recently, Western bankers had little or no idea what Poland, Romania or East Germany were doing with their money.

There was also some political pressure on banks to issue loans. American foreign policy was during this period recoiling from the Vietnam War. Military intervention was very ill thought of, and "economic pressure" and economic inducements seemed a more acceptable way to conduct one's foreign policy. Détente was the new policy toward the Soviet Union and its minions, and trade was encouraged across the Iron Curtain. In practice, this trade was impossible without Western financing, because the Warsaw Pact does not produce very much that is exportable except weapons and natural resources. This was not nearly enough to make up the overall difference.

Thus, there was political pressure to trade with the Warsaw Pact, and there was political pressure to carry on that convoluted process known as "recycling petrodollars." And in addition there was that most powerful factor, inflation, which is the certain result of easy money, to lubricate the whole vast mechanism of indebtedness.

Little wonder, with these conditions prevailing, that we have loaned such huge sums to Warsaw Pact nations, nations that are irrevocably hostile to the free financial institutions from which they have borrowed. Little wonder, too, that the Third World, non-oil producing nations have gotten in entirely over their heads. Their debt has now surpassed the \$500-billion mark. United States' banking exposure is now more than 112 percent of total bank capital in this country, and, among the nine largest banks, is more than

165 percent. The non-oil, lesser developed countries spend about one half their export earnings servicing debt and buying oil. That leaves precious little for importing raw materials or finished goods. A series of defaults could conceivably wipe out bank capital in this country.

Nor is a series of defaults inconceivable. The LDCs are being squeezed by the drop in inflation, by the high interest rates, by the depressed commodity markets, and by the heavy weight of their own past lending. It is true that some of them have been assisted by the drop in oil prices, but it must be remembered that for every Brazil, which imports immense amounts of oil, there is a Mexico or a Nigeria that must sell oil at huge prices in order to meet its liabilities. Indeed, last year OPEC itself was a net borrower, not a lender, which means that the petro-dollar recycling may be over for good.

Last February, Governor Wallich of the Federal Reserve made a worrisome speech about the increasing number of reschedulings among LDCs and Warsaw Pact nations. He implied that we are likely to see increasing numbers of them. He hinted that, for the first time, there is danger of reschedulings being forced by debtor nations for political, not economic, reasons. He allowed that this constitutes, or would constitute, a most serious danger to our banking system. He encouraged the IMF to be tough in imposing discipline on debtor nations; he encouraged banks and lending governments to exercise more caution — much more caution — in their international lending; he encouraged banks to begin to provide on their balance sheets for losses they had in fact realized, or were likely to realize, in international loans. He implied that the situation is likely to get worse before it gets better.

Repay or Default?

It is probable that this situation will have devastating effects in the Third World, particularly in Latin America. If the non-oil, lesser developed countries are to place their finances on a sound footing, they must take a series of steps that will make their immediate situations much more difficult. The subsidy of industries that cannot compete on the world market will have to be stopped. The supply of money will have to be bridled, and every effort will have to be made to protect the value of the currency on the international exchanges. This will cause, in the short term, higher interest rates, and these in turn will cause the bankruptcy of marginal, inefficient businesses, and perhaps even whole industries. There will be an increase in already high rates of unemployment. Governments that are already running wild deficits will see their budgets brought under even greater strain by a decline in revenues and an increase

in the need for poor relief. The lesser developed countries, which are already stretched in their finances and weakened by several years of falling commodity prices and rising interest rates, may still face the hardest stretch of road ahead.

They will, in short, have to go through what the United States and Great Britain have been going through. What Great Britain has been going through, and what the United States has been going through, will wreak havoc in the primitive economies south of the equator. Nor is the economic weakness of these nations separable from the fragility of their political life. In the few industrialized nations that boast democratic governments, the hard times are revealing deep divisions. In these Third World countries, deep political divisions are always apparent, and the appeal to force is never a remote possibility. It is unlikely, at best, that stable, moderate governments will manage to shoulder the heavy responsibilities that present economic necessities entail.

Thus it is that in Bolivia, a military junta, headed by President Guido Vildoso Calderon, has decided to hand back power to civilians. Under pressure from unions, and faced with a \$540-million interest payment to make by the end of the year, the intrepid generals thought it better to leave the crisis to less martial hands. The likely successor is one Hernan Siles Zuazo, who favors nationalization of domestic and foreign banks alike, and who is hostile to an IMF package that has recently been reported by the generals.

There are strong parties or factions in Mexico, in Brazil, in Argentina, in every large debtor country, that favor default. This will seem to some an act of rank expropriation, illegal and unjust. To make contracts freely, to rely upon foreign institutions for the import of raw materials and consumer goods, to bask in the sunshine of favorable finance for a period of years, and then to renege when the day of reckoning comes, will not contribute to the esteem, or the self-esteem, of a country. It will mean inevitably that ties with former friends will be severed. It will mean that for a long time the pattern of trade of the defaulting country must shift to a new direction. It will mean that new economic partners must be found.

Perhaps most importantly, it will mean that the act of default must be *justified*, at home and abroad. How can it be justified? What can be said to clothe in dignity a breach of faith? It takes little imagination to see that there is an argument readily available, an argument that will go much further than a mere exoneration of the defaulting nation. This argument has it that the defaulter is not a breaker of faith, he is a hero, and his act is a blow in the crusade for humanity.

In Latin America, where the debts are largest and the means of repayment least, the moral argument in favor of default is prominently displayed. Quite unexpectedly, Cuba has recently applied for rescheduling of her foreign debts, which amount to \$10 billion. It would seem an odd spectacle, the radical Castro, supplicant at the feet of capitalist bankers, asking for just a little more time. Perhaps, it has been muted in the press, we in the West ought to exercise a little of our vaunted leverage over Cuba, that leverage inherent in our status as huge creditors. That suggestion is, however, somewhat muffled by our experience with Poland. Cuba is no more a supplicant than was Poland. Cuba, like Poland, is confident in her moral position.

In her own mind, Cuba has not been borrowing money, she has been claiming from her oppressors what is rightfully her own. In her own mind, Cuba is not undergoing an economic crisis. As was announced on Cuban radio on September 14, Cuba's temporary problems stem from "a profound economic crisis" being faced by the capitalist system. Cuba's well-being is assured because Cuba maintains "favorable relations with the CMEA member countries, particularly the U.S.S.R."

The principles upon which Cuba's position rests have been made perfectly explicit recently on the official radio of Nicaragua, which is itself a heavy debtor nation. There was a conference of the United Nations' Food and Agriculture Organization in Managua early in September. It ran simultaneously with the Toronto Conference of the IMF, and it offered an alternative view of the international debt situation. In its report of the Conference in Managua, the Nicaraguan International Service had some definite criticisms to offer of the capitalist countries.

The United States, it was reported, had distinguished itself in Toronto as a "merciless moneylender." While the United States was busy opposing the increase in IMF resources, the thirty Latin American nations meeting in Managua had "come out in favor of a general moratorium on the payment of foreign debts. This difference of policy rested upon a profound difference of principle.

On one side we have the interests of the developed countries, especially those of the United States, which even unloads the crisis on its European allies. On the other side we have the needs of the underdeveloped countries, continually oppressed by a particularly anguishing situation in view of the current crisis. Anyone can understand that there would be natural differences of interest between the developed nations and the nations struggling with underdevelopment and backwardness. What cannot be understood or accepted is the difference in the price to be

paid by one or the other in view of the world crisis.

While the developed nations are concerned with stabilizing interest rates, the parity of their currency and creating an environment of trust during this crisis, the poor countries face malnutrition, worsening public health and increased hunger.

While in a developed country the crisis means that the freeway project will not proceed or the modern shopping mall will not be built, in a Third World country the crisis means that the hospital for that distant region and those schools, so badly needed, will not be built.

While the crisis will keep the U.S. man of the middle class from getting a new car this year, 15 million children will die of malnutrition in the underdeveloped world.

According, then, to the Cuban and the Nicaraguan point of view, the debt situation is an episode in the class war, an instance in the exploitation of the poor by the rich. The remedy is clear, and is perfectly consistent with what must always be the remedy for class exploitation. Resistance is called for, and in this case resistance will take the form of a debt moratorium.

Of course, if there is to be a debt moratorium called by the debtor nations, the pattern of world trade will be drastically affected. Faith, without which there cannot be credit, will be destroyed. The industrialized nations will suffer; but the developing nations may suffer much more. From whom will they buy? To whom will they sell? Who will supply the finance?

The debtor countries will have to regard the grave consequences of a massive default seriously. They would be extremely foolish to embark upon such an awful course without a plan, ready and waiting, to save their economies. Where would they turn for trade? The answer supplied by Cuba and Nicaragua is unmistakable: turn to the CMEA; turn to the source of Cuba's and Nicaragua's prosperity and happiness.

This may seem to us a ridiculous argument. We know that, purely from the point of economic well-being, the citizens of the West are far better off. We know that Cuba and Nicaragua, like Poland and Romania, are full of poor, tired, oppressed people who have little hope of betterment. We know that the power exercised from Moscow is much more rigorously applied than anything stemming from Washington. Surely the nations of Latin America will not be so foolish as to listen to the siren song of Cuba. It is too silly to contemplate.

Can we, however, be sure? Can we be sure that, to nations oppressed with a huge weight of indebtedness, these arguments will not carry an enhanced appeal? We must remember that Nicaragua and Cuba are in a position of com-

radeship, or of pretended comradeship, with the indebted nations. We, on the other hand, like it or not, are their creditors. We remind them of, we prevent them from escaping, the situation they are in, into which we have helped them. We have committed what may prove to have been a tremendous blunder. We have made it consonant — or at least more consonant — with the short-term, immediate interest of the most important Third World countries to listen to the Communists.

The effects of our foreign policy for the past ten years are now becoming apparent to us. We decided that our position in the world did not justify the use of force, even in places where our interests were at stake, and where other large powers were already intruding. We would not, however, simply withdraw from foreign contacts. Instead we would employ softer methods. Where, previously, a preponderance of strength had buttressed our position, now diplomacy and compromise would operate alone. But not quite alone. There would still be our vast wealth. There would still be the carrot, even if the stick were removed. Let us send a diplomat to the Middle East to make peace, and let us fill his briefcase with billions. Let us install an emissary in Rio or in Sao Paulo or in Managua, and let that emissary be employed, not by the State Department, but by a money center bank, with a liberal loan policy and inflated dollars to move. There is a policy acceptable even to the faint of heart. There is a policy that causes little disruption in the Congress at home, but is a great boon to the borrower.

We are learning now, however, that this policy was, to use the words of Winston Churchill, too easy to be good. We have made ourselves the creditor of these nations. They have mortgaged their futures for decades to come. This places a heavy burden upon their stability and moderation, which in any case have not always been exemplary. Immediate profit lies along the other road, following in the wake of Cuba and Nicaragua. We have schooled these nations for a decade in profligate finance; to a considerable extent we have set the example for them to follow. Who are we to object if they do not wish to pay? Who are we to complain if they look upon us with the distaste of the hopeless debtor for the owner of all his capital?

When we look back across our international financial policy for the last ten years, we see two themes, each dominating a distinct period. For most of the 1970s, we were irresponsible in the management of our own currency and in our fiscal policy. The lesser developed nations were encouraged or enabled to be much more irresponsible even than we.

Now we are attempting, in the United States and in several other industrialized democracies,

to travel the hard road back to prudent economic policy. The lesser developed countries are compelled to walk that road, too, and for them, the way is steeper and the motive power is less abundant.

At every stage, then, the Third World has been an exaggerated, even a grotesque, representation of our own faults and trials. We have regarded the Third World with sympathy, and often with fear. But we have managed in our sympathy and fear only to lead them, or to allow them to go, terribly astray.

What To Do?

The course that we have to navigate in the next few years will be at best a perilous course. We have to steer between two shoals: on the one hand lies inflation, and on the other, deflation. Every tack designed to avoid the one will increase the risk of grounding upon the other.

We may be encouraged that the United States remains, in the financial realm, the most powerful single entity. To a large extent, the financial policy of the United States has been imposing a discipline upon the rest of the world.

Eighteen months ago, it would have been thought ridiculous that European heads of state would be shuttling to America to complain that the dollar is too strong. We have grown accustomed to incessant complaints that the dollar is too weak. American goods are cheap in Europe, and the balance of payments in Europe, and economic activity generally, are hampered. Why then this grumbling that the dollar is too healthy?

Take, for example, the case of France. President Mitterrand was elected upon a radical, even a revolutionary economic program. He would nationalize, in one sweeping gesture, the basic industries of the nation. He would then begin a program of long-sighted investment, poising his country for the future. He would think not of next year, or the next, but of the next decade, and the decade beyond.

At every stage, however, his plan has been hampered by the strength of the dollar and the weakness of the franc. If President Mitterrand wishes to inflate the currency, he finds capital flying out of the country to America, where interest rates are high and returns excellent. If he wishes to lower his interest rates, if he wishes to run up enormous deficits, if he wishes to spend without taxing — in all these cases the same phenomenon stands in his way. The American war on inflation has made the dollar strong. The strong dollar has affected the economic policy of the other industrial nations.

To an even greater extent has it affected the economies of the debtor nations. It is no longer profitable to borrow in the way that it has been

for the last decade. Now it is profitable to borrow only if the money is to be wisely invested in an efficient enterprise. This means that the tempting prospect of sudden, easy, phenomenal growth is no longer open. Growth, it is now plain, can be won only by patient effort, applied within a context of moderate, free politics.

This is a hard lesson. Our sympathy rebels against telling distressed peoples that their difficulties cannot be removed overnight. But the alternative is even less attractive. We have tried, almost for a decade, easy money, ready credit, and inflation. At the end of that time, it is difficult to argue that the world is better off.

It is hard to blame the Reagan Administration for its furious efforts to rescue Mexico. It is also hard to blame it for its reluctance to double the regular funding of the IMF. These seemingly contradictory acts are, in fact, harmonious aspects of the proper middle course. We have to wean the poorer countries — and ourselves — away from easy money. But we have to do it gently, and gradually, and we have to ease the way however we can. The success of the Reagan Administration, both at home and abroad, depends upon its ability to follow this middle path.

— L. P. Arnn
Editor, *Grand Strategy*

Matters of Record

- According to Kabul Domestic Service in Pashto, a transit agreement for the export and import of commercial goods between Afghanistan and the U.S.S.R. was signed on September 1. Under the contract, facilities will be provided by the Soviet Union for the transportation of the goods both between the two countries and within Afghanistan.

- Manila domestic service reported on July 9 that during Philippine First Lady Svela Marcos' visit to Moscow, agreements were reached calling "for joint economic efforts in producing cement, prefabricated housing units, and oil. The cement plant, which will be set up by the Soviets, will have a production capacity of one million metric tons." On the same trip, Mrs. Marcos "accepted a sister city relationship between metro Manila and Moscow."

- From *La Nazione* (Florence, Italy), April 14: Thousands of Baltic and Eastern European refugees resident in Australia are victims of a methodical campaign of terror and extortion carried out by Soviet agents holding temporary visas, together with the staff of the Soviet embassy.

The Australian government is examining the evidence and sifting information supplied since the minister of immigration Ian MacPhee ordered an inquiry.

According to authoritative sources, the Soviet government has created a system for diverting to the Soviet Union donations and funds derived from the sale of properties of refugees deceased in Australia.

Thanks to a list prepared by representatives and secret agents who live in contact with the community, the Soviets have approached surviv-

ing spouses, counseling them to send at least part of the money to the Soviet Union, not infrequently threatening reprisals against relatives remaining in the native country to convince the more reluctant.

There are more than 10,000 refugees from the Baltic States and about 130,000 from Central and Eastern Europe. Their mortality rate increases continually because the majority (of those) present in Australia, as in Canada and the United States, are older than sixty.

According to experts on Soviet affairs, the directors of the Kremlin are compelled to use all the means at their disposal to cope with the problems caused by their engagement in Afghanistan and in Poland.

The intimidation of the refugees was denounced by the March number of the quarterly periodical *Baltic News*, released throughout Australia, and by the Lithuanian weekly *Teviskės Aidai*, which in the edition of January 30 wrote:

"The Soviet usurper who forced us to leave our houses once again stretches out his hand, this time for properties ours by toil."

- U.S. officials are using reconnaissance satellite photographs of three new, operational Soviet SS-20 nuclear-armed intermediate-range ballistic missile sites to convince the North Atlantic Treaty Organization that the U.S.S.R. has violated its own ban on continued deployment of the weapon. According to *Aviation Week & Space Technology* of September 13, each of the sites contains nine of the mobile SS-20 launchers. Deployment of the SS-20s at the three bases brings operational SS-20s in Europe to a total of 324.

• According to *Aviation Week & Space Technology*, September 6, the Soviet Union is developing a new version of its mobile, radar-controlled ZSU-23-4 antiaircraft gun, first used in the October 1973 war in the Middle East. The weapon is designated ZSU-X by the U.S. Army, which is working on a jammer to stop the gun's lock-on capability against helicopters and other low-flying aircraft.

• On July 23, Melbourne Overseas Service reported an interview with Mr. Lionell Bowen, deputy leader of the Australian Labor Party and its spokesman on Foreign Affairs. According to Mr. Bowen, if the Labor Party, now in opposition, wins the next election, it will work to establish a nuclear-free southern hemisphere.

Mr. Bowen believes that it is possible to persuade "all the countries in the southern hemisphere, including the oceans — with the Pacific and Indian Oceans, and people who are in those areas — to come to an agreement that we have a nuclear-free zone." Warships would be allowed in the zone but not the launching or storage of nuclear weapons. Mr. Bowen, who has in the past often advocated recognizing the Vietnamese-backed government in Cambodia and resuming aid to Vietnam, also remarked that "Indonesia... would be of undoubted benefit to us in our negotiations together in the whole of Southeast Asia relating to ASEAN and Vietnam so they would be a partner in terms of peace and stability in the region."



The World in Perspective

Zimbabwe: The External Threat

Relations between Zimbabwe (formerly Rhodesia) and the Republic of South Africa (RSA) have been rocky ever since the former's independence from Britain and the election of Robert Mugabe as Prime Minister of the new nation.¹ Mugabe, as a black African and a Marxist, has spoken out frequently against South Africa's white minority government, its system of apartheid, and its involvement in Namibia. South Africa, for its part, is not at all happy to have yet another hostile, Marxist-ruled nation on its borders, and one which is steadily and deliberately becoming a one-party state.²

Despite these political differences, Zimbabwe remains economically dependent on South Africa. Because Zimbabwe is landlocked, it relies heavily on South African railways and port facilities for getting its grain and mineral products to world markets and for receiving goods from other countries. South Africa is also Zimbabwe's number one trading partner, supplying one third of its imports and buying one fifth of its exports.³ This is more than three times the amount of Zimbabwe's trade with Britain, its second largest trading partner.⁴ Earlier this year South Africa extended a preferential trade

agreement with Zimbabwe which had been due to expire in March. This agreement — which exempts Zimbabwe's exports from tariffs and quotas in South Africa and reportedly saved the country 6,000 jobs and \$40 million of export trade — was especially important to Zimbabwe's faltering economy.⁵

Disident Activity — The South African Connection

Because of Zimbabwe's economic dependence, Mugabe's policies have fallen short of his militant anti-South African rhetoric. Zimbabwe has not granted diplomatic recognition to any anti-South African guerrilla organizations, nor has it allowed any of them to establish bases within its territory.⁶ Mugabe has, however, allowed the African National Congress (ANC) to open an office in Harare (formerly Salisbury), and has pledged his support for the organization.⁷ This angered South Africa's leaders, provoking Prime Minister Pieter Botha to respond that "The ANC will only open offices there if they wish to organize direct action. Should that happen, we will deal with it in the way we find proper."⁸

After a rash of bombings in South Africa in 1980 for which the ANC claimed responsibility, the South Africans evidently felt compelled to retaliate. On July 31, 1981, Joe Gqabi, head of the ANC in Zimbabwe, was shot to death outside his home in a suburb of Harare. Although no one was charged in the killing, officials blamed it on South African saboteurs.

Officials have blamed South Africa for other acts of sabotage in the recent past. On August 18, 1981, several explosions destroyed tons of arms and ammunition at Zimbabwe's Inkomo military camp. The destruction was originally blamed on accidental gas-cylinder explosions.⁸ The government later changed its opinion on the explosions, claiming that they had been the result of sabotage. In October of 1981, a white army officer, Captain Frank Gericke, was arrested in connection with the blasts and "on suspicion of spying for South Africa."¹⁰ Gericke was later said to have escaped with the help of his jailor and to have fled to the RSA.

Two South African-backed spy rings have reportedly been uncovered in Zimbabwe in the last ten months. The first involved four white Zimbabweans who were arrested last November 20 and were convicted of conspiracy in May. This group was reportedly involved in a plan code-named "Operation Assegai." Their plan allegedly envisaged raids on military garrisons, acts of sabotage on economic projects, and the destruction of the main transport routes through the province of Matabeleland.¹¹ The goal of these operations, according to the prosecutor in the case, was to incite a rebellion in Matabeleland, resulting in the transformation of that province into an independent nation supported by South Africa.¹²

On March 28 of this year, Zimbabwe's Minister of State announced that another spy ring had been discovered. This one involved three white men, all former members of Zimbabwe's Central Intelligence Organization. A Mr. Price, who had been director of close security in the CIO, with responsibility for the safety of the Prime Minister and Cabinet, was accused as the leader of the ring. Price fled to South Africa before he could be apprehended.¹³

Zimbabwe has also accused the RSA of mounting other subversive activities against itself. The leaders of both Zimbabwe and Mozambique have reported that about 5,000 troops are training in South Africa for guerrilla activity against their countries.¹⁴ According to officials in Zimbabwe, these troops include both former Rhodesian army members and supporters of former Rhodesian Prime Minister Bishop Abel Muzorewa.¹⁵ On April 4, Mugabe announced that some of these antigovernment forces had returned to Zimbabwe on a mission and were arrested.¹⁶ On August 18, the government

announced that its troops had killed three other white South African troops inside its border. The men were identified as former Rhodesian soldiers who had emigrated to the RSA upon Zimbabwe's independence.¹⁷ Pretoria denied the reports at first, but later said the men were part of its armed forces and had been on an unauthorized mission.¹⁸

New allegations followed on the heels of the August 18 killings. A story in Zimbabwe's national newspaper, the *Sunday Mail*, quoted several South African soldiers as saying that the slain men had, in fact, been on an authorized mission. The soldiers, all former members of the Rhodesian military, were also quoted to the effect that they are regularly deployed in raids on neighboring black nations and that Pretoria has a special "destabilization center" within its defense headquarters which coordinates those raids.¹⁹

The presence of these former Rhodesian troops in its military no doubt enhances South Africa's ability to mount subversive campaigns against Zimbabwe. The Rhodesians are familiar with Zimbabwe's military capabilities and vulnerabilities, and they have contacts with former colleagues who remain in Zimbabwe. For Mugabe, however, this presents a serious problem. He is no longer sure which — if any — of his white security officers maintain ties with expatriate friends now in South African employ; and he has, in fact, accused some members of his military and police forces of passing information to the RSA.²⁰

The Mozambique National Resistance Movement

South Africa has reportedly been supplying arms and equipment to the Mozambique National Resistance Movement (MNR), a pro-Western guerrilla organization which is fighting against the Soviet-backed government of President Samora Machel.²¹ The MNR, which boasts 16,000 fighters, has concentrated on destroying the communications links between Zimbabwe and Mozambique. The MNR has targeted two railways connecting Zimbabwe with the Mozambican ports of Beira and Maputo — Zimbabwe's only railways to the sea except through the RSA.²² Also targeted is the oil pipeline running along the railroad from Beira to the Zimbabwean city of Umtali. This pipeline was scheduled to reopen last December, having been out of service for 15 years.

On October 29 of last year, the MNR claimed responsibility for destroying two important bridges over the Pungwe River, on the Beira-Umtali route.²³ The attack disrupted all rail and road traffic between the two cities and delayed the opening of the pipeline until the middle of this year. The pipeline functioned for

only a few weeks before it was sabotaged again early in August. The MNR also claimed at about the same time to have destroyed a train on the railway to Maputo.²⁴

The South Africans had very good reasons for wanting to see these rail and pipeline systems disrupted. First, the bottleneck on the railways is forcing Zimbabwe to export more than half its goods through South African ports.²⁵ Second, the pipeline shutdown compelled Zimbabwe to turn once more to the RSA for the better part of its petroleum imports. Both of these factors increase Zimbabwe's economic dependence on South Africa, reducing its freedom to oppose the RSA's political system.

But South Africa had more than economic reasons for wanting to see the railroads shut down. Just before the Pungwe River bridges were blown last October, over \$20-million worth of military equipment from North Korea was shipped to Zimbabwe via the Beira-Umtali line.²⁶ This equipment was used to arm Zimbabwe's Fifth Brigade, which was being trained by North Korean military advisers.²⁷ In September of 1981, the South African newspaper *Beeld* reported the movement of another shipment of military equipment over the same route, a movement which was, no doubt, of even more concern to the RSA.²⁸ According to *Beeld*, billions of rands worth of Soviet-made weapons were transhipped from Beira, through Umtali and Harare, to Francistown, Botswana. This shipment included 100 SAM-7 missiles, along with various other missiles; thousands of AK-47 rifles; millions of rounds of ammunition; 30 armored troop carriers; and tons of explosives. These weapons were to be used to arm refugees from South Africa, who were in a large camp in northern Botswana, for guerrilla activities inside the RSA.

The military and the economic importance of the railways, then, make them prime targets for South African-sponsored guerrilla activity. By shutting them down, the RSA can force Zimbabwe to import its goods through South African ports. This serves the dual purpose of prolonging Zimbabwe's dependence and of allowing the RSA to monitor and regulate carefully the types of goods brought into the region.

The Attack on Zimbabwe's Air Force

In July of this year, raiders struck at the Thornhill air base, destroying 13 of Zimbabwe's aircraft.²⁹ Destroyed were eight *Hawker Hunter* fighter-bombers, a Cessna spotter plane, and four *Hawk* fighters which had been delivered by Britain only days before. The raiders taped plastic explosives with air-force-type detonators inside the engine compartments of the planes.³⁰ Since the job required intimate knowledge of the compound area and since the explosive



Map of Africa. (Government Publications Document)

devices were very sophisticated, most observers feel that the job was not the work of black dissidents of Joshua Nkomo's party.³¹ In any case, 17 white air force officers, including four top officials, have been detained for questioning, and the air force has been grounded.³²

South Africa was not without reason to wish to see Zimbabwe's air force weakened, and it is at least possible that the attack was ordered from Pretoria through its Rhodesian connection. Mozambique and Zimbabwe held high-level military talks in November 1981, the purpose of which was to study and coordinate the defense of the border area between the two countries where the MNR has concentrated its attacks.³³ Zimbabwean aircraft were subsequently sent to Mozambique to help a joint force of Mozambiquan-Zimbabwean troops in action against MNR forces.³⁴

The operations in Mozambique underscored Zimbabwe's need to update its antiquated air force in order to deal with brush-fire conflicts such as the one stirred up by the MNR. Accordingly, the government moved to replace its old

Vampire turbojet trainers with the British *Hawks*. Altogether, eight *Hawks* were purchased, and the first four flew in on July 16.³⁶ After the sabotage on these and the other aircraft, Mugabe was left with little more than a few helicopters and a dozen ancient Dakota transports.³⁸ These are nearly exhausted by the abnormally high number of hours they put in during the Rhodesian army's fight against Mugabe's and Nkomo's guerrillas in the 1970s.³⁷ It is unlikely that Zimbabwe's air force could now mount an effective attack against the MNR or any other guerrilla forces.

Prospects for the Future

Despite the hopes of many in the West, Robert Mugabe is unlikely to abandon the militant Marxist ideology that he acquired during many years of revolutionary struggle against the Rhodesian regime. Nor is he likely to give up the vision that most black Africans share of an

entirely black-ruled southern Africa. For this reason, we must expect Mugabe to continue to oppose the white minority government of South Africa and quietly to give all possible aid to organizations dedicated to overthrowing that government.

On the other hand, it would be just as unrealistic for us to expect the government of South Africa to stop defending its interests by allowing neighboring countries' hostile actions and words to go unchallenged. The RSA is likely, then, to continue its attempts to destabilize Zimbabwe politically in order to divert Mugabe's attention from itself. In any case, with unrest growing in Zimbabwe on account of economic woes and the dissident activities of Joshua Nkomo's followers, Mugabe is in a precarious situation, and the RSA will continue to have the upper hand in the area for the foreseeable future.

— Wesley G. Phelan
Claremont Graduate School

Footnotes

¹Mugabe's ZANU party swept to victory in the British-supervised elections on Feb. 27-28, 1980. The new officials were sworn in, and British rule formally ended, on April 18, 1980.

²See *Grand Strategy*, Oct. 1, 1982, for details of Zimbabwe's political situation.

³"Bloodletting in Bulawayo," *Newsweek*, Feb. 23, 1981, p. 50.

⁴"The Great Black Hope," *South China Morning Post*, Dec. 20, 1981, p. 2.

⁵"South Africa Warns Up to Black Neighbors," *Christian Science Monitor*, April 22, 1982, p. 7.

⁶*Foreign Broadcast Information Service*, Middle East and Africa (hereinafter referred to as *FBIS*), June 21, 1982, p. U3.

⁷The ANC is a radical guerrilla organization, made up of black South African refugees, and dedicated to the overthrow of the government of the RSA. The U.S.S.R. is its chief financial supporter.

⁸"Black Nationalist from South Africa Slain in Zimbabwe," *Washington Post*, Aug. 2, 1981.

⁹*Keessing's Contemporary Archives*, June 25, 1982, p. 31553.

¹⁰"White MP Arrested in Tense Zimbabwe," *South China Morning Post*, Dec. 12, 1981.

¹¹*FBIS*, March 1982, p. J2.

¹²*Keessing's*, June 25, 1982, p. 31553. Matabeleland is the powerbase of Joshua Nkomo, whose Ndebele tribesmen are chafing under Mugabe's rule. Since four men obviously cannot stage a rebellion alone, the government probably suspected that they intended to supply the Nkomo group with arms and other aid. RSA connections with dissident Nkomo forces have long been suspected but never proven by the government.

¹³*FBIS*, March 29, 1982, p. U3. *Keessing's*, June 25, 1982, p. 31553.

¹⁴"Mugabe Warns of South African Invasion Plan," *Africa News*, Aug. 30, 1982, p. 3.

¹⁵Bishop Muzorewa—head of the United African National Council Party which currently holds three seats in Zim-

babwe's Assembly—was Prime Minister of Rhodesia under Ian Smith's Internal Settlement Plan, which transferred some power to the blacks in 1979.

¹⁶*FBIS*, April 6, 1982, p. U4.

¹⁷"The Zone of Instability," *Newsweek*, Sept. 6, 1982, p. 36.

¹⁸"New Charges of Covert Action by Pretoria," *Africa News*, Sept. 13, 1982, p. 1.

¹⁹It should be stressed that the news media in Zimbabwe is owned by and is under the strict supervision of the government (see *Grand Strategy*, Oct. 1, 1982). The *Sunday Mail*, therefore, cannot be regarded as an absolutely reliable and impartial source.

²⁰*Keessing's*, June 25, 1982, p. 31553.

²¹The Rhodesian Central Intelligence Organization formed the MNR several years ago to divert Machel from supporting Mugabe's guerrilla activity. "Zone," *Newsweek*, Sept. 6, 1982, p. 36.

²²"South Africa to Open Talks with Zimbabwe on Renewing Trade Pact," *Washington Post*, Jan. 8, 1982, p. 19.

²³*FBIS*, Nov. 3, 1981, p. U3.

²⁴*FBIS*, Aug. 16, 1982, p. U2.

²⁵*FBIS*, Aug. 5, 1982, p. U2.

²⁶*FBIS*, Nov. 18, 1981, p. U4.

²⁷The Fifth Brigade recently completed its training, and the advisers returned home. *FBIS*, Aug. 20, 1982, p. U5.

²⁸*FBIS*, Sept. 23, 1982, p. U3.

²⁹Zimbabwe's main air base. Training and fighter squadrons are stationed there.

³⁰*FBIS*, Sept. 7, 1982, p. U4.

³¹"Mugabe Links Foes to Kidnappings," *Washington Post*, July 30, 1982, p. 16.

³²*FBIS*, Sept. 7, 1982, p. U4. "Black Africa in Turmoil," *Newsweek*, Aug. 16, 1982, p. 38.

³³*FBIS*, Dec. 2, 1981, p. U5.

³⁴*FBIS*, Dec. 7, 1981, p. U3.

³⁵The Hawk trainers can double as light fighter aircraft.

³⁶"Terrorists Shatter Mugabe's Peace," *Newsweek*, Aug. 9, 1982, p. 35.

³⁷*FBIS*, Feb. 17, 1982, p. U3.

The Editorial Board of *Grand Strategy: Countercurrents* includes: Editors, Patrick J. Garrity and L. P. Arnn; Executive Editor, Harold W. Rood; Contributing Editors, Jack D. Crouch II, Christopher Flannery, Harold Johnson, and Thomas B. Silver; Cartographic Illustrator, N. L. Diaz; Editorial Advisers, Stephen A. Cambone (Los Alamos Scientific Laboratory), Christopher C. Harmon (Claremont

Graduate School), Steven A. Maaranen (Los Alamos Scientific Laboratory), and Peter W. Schramm (The Claremont Institute for the Study of Statesmanship); Research Assistants, Eldon Alexander and Mickey G. Craig.

Editorial correspondence is encouraged and may be sent to Editor, *Grand Strategy: Countercurrents*, 480 North Indian Hill Blvd., Suite 2, Claremont, California 91711, telephone (714) 621-5831.

GRAND STRATEGY

C O U N T E R C U R R E N T S

Vol. 2, No. 4

February 15, 1982

Polish Debts: The Economic Strategy of An Empire

Contents

Polish Debt: The Economic Strategy of an Empire
World in Perspective: Poland: One Defector's
View.
Retrospect and Prospect: Iran and the World.



San Francisco headquarters of Bank America, Poland's largest American creditor

Polish Debts: The Economic Strategy of An Empire

On Tuesday, December 15, 1981, the martial law government of Poland was only three nights and two days old. Already, several hundred—perhaps several thousand—people had been arrested. Already, the union Solidarity, despite its ten million members, despite its national organization, despite its shrewd and courageous leadership, and despite its implacable determination, had been divided and broken. Already the expected uprising of the Polish people, whose spirit was said to ring the death knell for tyranny in Eastern Europe, had been suppressed. The operation that achieved these extraordinary results was so swift that, by the time the world knew it was happening, it had already succeeded.

No sudden, massive influx of Soviet soldiers was needed. No armed and organized resistance was met. The Polish Army, whose loyalty to the Soviet Union was believed to be suspect, had for months been training to deliver this sudden blow. It was a devastating success.

The West was blind while these events transpired. For two days the Polish Government allowed no communiques from Western embassies, and press reports were speculative and sparse (as they are still). Then, on Tuesday afternoon, December 15, twelve Western ambassadors in Warsaw were summoned to see, not the Prime Minister, but the Finance Minister, Mr. Kzrak. As this unusual meeting was convening, the state bank of Poland, Bank Handlowy, dispatched a telegram to several of the world's largest banks. Mr. Kzrak, in his meeting with ambassadors, and the Bank Handlowy, in its telegrams, were both putting forward the same request: Poland wished to borrow several hundred million dollars.

It may seem remarkable that a communist regime, fresh from the successful completion of brutalities and repressions that are odious to liberal principles, should re-open its relations with liberal governments and liberal institutions by requesting large sums of money. But even that is not so remarkable as the purpose for which these loans were requested.

It has become well-known in the last six months that Poland is heavily indebted to Western nations and to Western banks. Like most financial news that becomes interesting to the general public, this news is well known because it is bad. Poland is in debt to the West by a sum of more than twenty-seven billion dollars, and Poland has defaulted. This default occurred sometime in the third quarter of 1981, and since that time Poland and her creditors, but most of all her creditors, have been toiling mightily to forestall the cumbersome proceedings of national bankruptcy that should follow such a massive financial failure.

About \$10.5 billion of Poland's debt is owed to sixteen Western governments. The taxpayers that support those governments have, at least for the time being, taken it upon themselves to pay the interest for Poland. There is little danger of legal declarations of default in regard to these government to government loans, because the creditor governments have displayed an almost saintly flexibility. They would rather write the money off as a foreign policy expenditure than declare a default, seize Polish assets and attempt to recover the rest of their property in courts of law.

Poland also owes more than \$16 billion to Western banks. Shortly after Poland stopped re-paying western governments either interest or principal, it called upon its creditor banks, now numbering more than 500, to "reschedule" the \$2.5 billion it was obliged to pay to banks in the last half of 1981. It has required the closest cooperation among the 500 banks to protect Poland from bankruptcy proceedings, which would begin if even a single major creditor should go to court. During a complicated period of negotiation, which has lasted for more than six months, not one bank has sued for its money. Instead, an arrangement was finally reached among the banks at the beginning of October 1981. Poland would be required to pay ninety-five percent of the principal falling due in 1981 in annual installments, the first payable on December 10, 1985, the last payable on December 10, 1988. Five percent of the principal falling due in 1981 would be payable on December 10, 1982. And finally, all of the interest on deferred 1981 payments would have to be paid every year without fail. The first interest payment, amounting to almost \$500 million, would be payable on or before December 31, 1981.

It must be realized that these arrangements, which were worked out with the utmost difficulty, have only to do with the amount of Poland's debt that fell due in 1981. As the negotiations were going

Grand Strategy: Countercurrents (2nd Class Permit Pending, Claremont, CA, 91711; ISSN 0277-3163) is published bi-weekly except mid-December for \$30/year personal; \$15/year institutional; \$15/year overseas (back issues, \$2 each) by Public Research Syndicated, 201 West Fourth Street, Suite 200, Claremont, California, 91711. Application to Mail At Second-Class Postage Rates is Pending At Claremont, California. POSTMASTER: send address changes to *Grand Strategy: Countercurrents*, 201 West Fourth Street, Suite 200, Claremont, California 91711.

on, it was understood that a similar process would be necessary to arbitrate Poland's 1982 obligations, too, which Poland would be likewise unable to pay. The same would probably be true for 1983, and for 1984. In fact, Mr. Krzak let it be known that he imagined that nothing less than \$10 billion in extra borrowing, solely for the purpose of paying interest on unpaid and delinquent principal, would be necessary to enable Poland to weather the next four years. And of course there would be other heavy requirements for the financing of imports.

That was the background against which the bankers worked to devise a rescheduling plan. What they finally offered to Poland may seem exceedingly lenient, but it reflects the dilemma in which the banks find themselves. If they were to cut off negotiations and file default proceedings, Poland's assets abroad could be attached. But these assets—deposits in foreign banks, ships, aircraft, commodities and equipment already paid for—are worth only a fraction of the money owed. Thus it seems advisable to continue to do business with a bad risk, even if that bad risk constantly pleads for further credits.

However lenient the proposed rescheduling may seem to us, it does not satisfy the Poles. The Polish government was displeased to be asked to pay anything at all in 1981, and has still not paid the \$500 million that was demanded by December 31, 1981. It was this sum that the martial law government, as one of its first acts, asked to borrow. This indicates the chaotic state of Poland's finances.

The events that have followed this December 15 Polish credit application are cloudy. First, the banks held a meeting in Zurich, and refused to loan any more money to Poland on its 1981 obligations. Then, rumors began to circulate that Poland had come up with the money, and that the Soviet Union was the source of the funds. And because the Soviet Union was borrowing money at the time from West Germany, it seemed that West Germany was indirectly bailing Poland out. Eventually, however, it became apparent that Poland had not—and has not—come up with the entire \$500 million it was required to pay in 1981. It is probable that some banks, those most likely to take legal action, have been paid. Even this, however, is difficult to ascertain. The interests involved are so diverse and their intentions so conflicting that the stories issued in various cities, even on the same day, contradict one another as often as they agree.

On December 30 reports began to circulate in the press that Poland would in fact be able to pay the money, but probably a little late. Austria's Creditanstalt-Bankverein received a telex communication on that day from the Bank Handlowy promising "a substantial payment," and "soon." In Zurich, Mr. Guido Coudray, who heads something called a "multinational task force" that represents the 500-plus creditor banks, announced that he

knew of "several" banks that had been paid. He expressed his confidence that Poland was doing its best, and he said that a declaration of default for these interest payments was "out of the question." He said that compound interest would be calculated on unpaid interest "as in any other business transaction." This comment rather lost sight of the history behind this particular interest payment. The Polish financial condition had long since lost any resemblance to an ordinary business situation.

On January 25, reports were published that the Bank Handlowy had promised to pay the amounts remaining on its 1981 account "by mid-February." If that happens, the creditor banks will be willing to sign a legal document rescheduling Poland's 1981 debt. Also, negotiations will begin over the rescheduling of Poland's 1982 debt. Once again, several billion dollars will be involved. Once again, the sums in question will have only to do with the servicing of Poland's debt. Additional staggering sums will be required to finance Poland's imports. The problem is therefore certain to become more acute as time goes on. There will be mounting pressure on Western governments to guarantee ever greater portions of the total debt outstanding. This pressure will be resisted by some of the governments, which will seek to stop the Polish debt from continuing its explosive growth. But no government would be willing to allow one of its major banks to be crippled or destroyed by a Polish default. That is why governments are becoming increasingly involved as guarantors. That is one reason why governments and banks are both willing to extend new credits rather than force a showdown now.

We shall probably, then, be compelled to deal with this situation for many years to come. There are several schools of thought about the effect that it will have upon our foreign policy and our standing in the world. Some believe that we have, by assuming certain risks and disbursing certain funds, placed ourselves in a position to "woo" the Poles away from the Russians. Some believe that we have at last found a method of projecting force behind the Iron Curtain, and that we should begin to plan how to exercise our new power. Some believe that we have laid the ground work for a more intimate cooperation with the Soviet Union, in which the superpowers would join together to enforce financial responsibility and the paying of debts. Some believe that, out of duty to the oppressed Polish people, we are obliged to extend the delinquent loans, and even to make new ones.

All of these opinions, which together dominate thinking on this subject, rest upon the perception that we are in the stronger position. It is the Poles and the Soviets who are in trouble. It is they who are to be pitied, as one would pity a neighbor who could not provide for his family. It is they who should be disciplined, as one would discipline a weak-willed man whose vices make him a menace to himself. We

the creditors need only threaten to declare the debtors bankrupt in order to have our way.

Those who believe that we hold the upper hand admit that we ourselves face certain dangers. For example, if we did declare Poland in default, we should certainly lose a lot of money, which we could ill afford. But the Soviets and the Polish government, it is contended, would suffer even greater harm. They would, above all, lose their future access to Western credit, and therefore to Western capital. Their economic development would be arrested. Their standards of living would deteriorate. Additional hardship would be imposed upon the peoples of the Warsaw Pact, who are already on the edge of rebellion. No, the Soviet Union could never risk a declaration of default. They would have to intervene to help, if not to compel, the Poles to repay the money.

This, as we said, is the prevailing view of the situation regarding the Polish debts. It rests upon the belief that the "demand for consumer goods" behind the Iron Curtain is, if not irresistible, at least too powerful to be ignored. It rests upon the belief that the Soviets and Warsaw Pact economies would be gravely if not fatally impaired by the loss of Western technology and food, and that the damage would be done in areas that are vital to the plans of the communist leadership. It rests upon the belief that without Western loans they could not afford even the Western products that are essential to their well-being. And it rests upon the belief that this process of borrowing from and trading with the West has been, to a significant extent, forced upon the Soviet Union by the internal dynamics of its empire.

It is quite possible that all these beliefs are in fact close approximations of the truth. But it is also possible that some or all of these beliefs do not resemble the true situation. If they do not, the Polish debts may have an entirely different meaning from what is commonly thought. It may be that communist trade with the Western countries, and the borrowing that makes it possible, is conceived in the Warsaw Pact as part of a more general strategy, a strategy that happens to have financial and economic components, as well as military and diplomatic components.

It would not be surprising to learn that the Soviet Union and its allies deploy even their economic relations with other countries as instruments in a strategic plan. Consider the example of the internal Soviet economy. It is what is called a "command" economy, as opposed to what we have, a "demand" economy. It is an economy designed to produce, not what the great majority of the people wish to have, but what the ruling few think is best. The Soviet economy is a tool in the hands of the party. The purpose of the Party is to transform society, to transform every individual in it, in order to create a different type of being, a type capable of living in perfect freedom. The economy is in fact the most

important instrument for effecting this most important purpose, because, in Marxism, man is shaped and formed by his relations with the material things around him, by his relation to the process of production and to the other creatures involved in that process. The very term "communism" refers to a way of arranging economic life. The Soviets are, therefore, experienced in manipulating economic relationships, and the reasons they give to justify their manipulations go far beyond immediate or short-term expediency.

We must, therefore, take into account the possibility that the accumulation of this huge debt has been an act of policy by the communist states. And once it is considered in that light, as a deliberate act, and not the result of accident, or bumbling and folly on the part of the borrowers, the phenomenon takes on a different aspect. When one tallies up the profits and losses that have accrued to the Warsaw Pact as a result of this borrowing, one certainly can find entries for both columns. However, the profits for the borrowers are for the most part tangible advantages that have already been reaped, and the losses are for the most part intangible, or contingent upon future events turning out the way we expect.

It is probably true, for example, that the Soviet Union and Poland have suffered a "propaganda defeat" from what has happened in Poland. It has been explained in the Western media, more often than is usual, that the Communist countries lag behind the West in GNP. The ruthless methods of communist rulers, or a mild representation of these methods, have been displayed, discussed and condemned more often than is normal. This is certainly a good thing, and the politburos and the central committees are probably not happy about it. On the other hand, the West won these same "propaganda victories" after the invasions of Hungary, Czechoslovakia and Afghanistan, and somehow they do not seem to have been at all decisive. In each case things have returned to normal in a short time, and the effect of the adverse propaganda has not lasted. Moreover, right up to the day that martial law was declared in Poland, press stories dwelled upon the imminent demise of tyranny in Poland. They predicted that the approaching revolt in Poland would set off a chain of events that might, over a shorter or longer period, end in the break-up of the Soviet Empire. This kind of talk may make the Soviets look bad, but it also tends to blunt our own sense of danger and to enervate our efforts to defend ourselves. We can relax, the conclusion goes, because our enemies seem to be in confusion.

Then we must wonder, has Poland really come to that day of reckoning when it must pay the penalty for its prodigal conduct? For nine years, Poland has eaten at the Western table. It has imported Western wheat and Western capital. It has set itself up a steel industry, a computer industry, and a tractor industry. It has modernized its coal mining equipment. Now, it is said, the

notes are due, the food is gone, and although the capital equipment remains, it is not, in Polish hands, capable of generating sufficient revenue to pay back the loans. Poland will have to come up with the money from its own resources. That means hard work and privation for the Polish people, and danger for the Polish leaders.

In order to evaluate this argument, one must remember that until the Poles actually repay the loans, the food they have consumed and the capital they have imported is not expensive to them at all. It is incredibly cheap. The spanking new Polish steel mill may not be an efficient and wise investment by our standards, but it is a large and modern steel mill, and so far someone else has paid for it. The Poles will have been proved foolish if and when the day of reckoning comes, but not before. That day is not yet upon us.

First of all, it is not at all certain that Poland has exhausted its line of credit. One need only remember that the Reagan administration, despite the imprecations of Secretary of Defense Weinberger, is at this moment busily paying off certain food loans that were made to Poland. These loans were made by private banks, and the U.S. Government guarantee was issued by the Commodity Credit Corporation. The U.S. Department of Agriculture is obliged to pay the banks if and only if the Poles fail to do so, that is, if and only if the Poles default. The Poles have defaulted, and the U.S.D.A. is paying. But it is making careful stipulations in public that we can not consider this a default. If Reagan will not declare the Poles in default, who will? So far, no one has, and aid and credits are flowing into Poland—admittedly at a reduced rate—every day.

If Poland should find itself unable to obtain new funds, there are always the other Warsaw Pact nations. There is Hungary—with an economy that is thought to be the wonder of the East, and with membership in the IMF almost within its grasp. Hungary could put together a run on Western banks and governments of several years duration. Hungary could be compelled, as easily as Poland has been compelled, to spread the profits among its friends. There is also East Germany, whose claim upon the sympathies of West Germany is a potential asset of considerable value. There is Czechoslovakia, whose debt to the West is \$1.8 billion and rising—a considerable sum, but not excessive by today's standards. Even Romania, whose finances are bad, will probably be able to take out some loans on the strength of its vaunted independence from the Soviet Union. Western bankers would like nothing better than to spread the liabilities around among the Soviet allies, hoping to tie their loans to a greater collateral base.

Finally, there is the Soviet Union itself, which could serve as a vast reservoir of credit. The Soviet Union has so far been unwilling to take upon itself a portion of the Polish burden. It claims to have sent considerable monetary aid to

Poland, but this cannot be verified. What can be verified is that the Soviets have not "opened the umbrella" for Poland; the Soviet Union has not come in to pay off even the overdue interest on Poland's loans. The banks, which were confident this would be done, have been a little chagrined by this. It is believed that this refusal by the Soviets is caused by the Soviets' own financial condition. The Soviets are said to be strapped themselves. But of course we do not know this, because we do not know very much at all about the Soviet economy. We know that the Soviet Union makes most of its money by mining and selling gold, oil, natural gas and strategic metals. How large are its reserves, how steady is its production, how heavy are its sales—these are Soviet state secrets, and we can only make the crudest guesses about them. The CIA estimates of the declining Soviet oil output are an example of how crude these guesses are, and how widely disputed they are.

The prevalent notion that the Soviet Union is broke is based upon a few meager bits of information: the Soviet Union seems to be selling more gold and oil than it had been recently; it seems to be borrowing more money than it had been recently; its annual bad harvest has been announced; its deposits in foreign banks are down sharply; and it has asked the Japanese for a six month extension on a loan. This information does indicate that the Soviets are gathering and spending more foreign exchange than has been usual recently. But it does not tell us very much about the ability of the Soviet Union to generate foreign exchange over time. Bankers know this, and they know also the vast material resources of the Soviet Union. This—coupled with the still accepted maxim that sovereign states do not default, they only roll debts over—will ease the bankers' fears. The logic that enabled Poland to borrow \$27 billion would enable the Soviets to borrow many billions more.

If the Soviet Union chose to float massive debts, it would from time to time encounter resistance from the credit markets. But there would be the enormous political clout of the Soviet Union to help remove the resistance. It is reported that several of the largest West German banks, whose balance sheets have become questionable because of the Polish situation, have been reluctant to provide the massive financing for the Yamal pipeline. The project, however, goes ahead smoothly because 90% of the \$1.13 billion already loaned has been guaranteed by the West German government. This kind of lubrication is perfectly effective with the banks. It costs the government nothing to give the guarantee. The possibility of default, years down the road, does not exercise much sway over deliberations today.

It is probable, then, that the Warsaw Pact nations can put off the dread day of reckoning for years. By working the credit markets with vigor and ingenuity, they can continue for an indefinite period to pay the interest of the last loan with the principal

of the next one. That is one of the most worrisome aspects of this problem.

The Soviet Union, it might be thought, should be uncomfortable with the prospect of accumulating a massive debt such as Poland's. But the Soviet Union seems to have its own set of criteria for judging such things. For one thing, much can happen over a period of years to alter the nature of the obligation. There is the possibility of a fundamental realignment of power in Europe. There is the possibility of a radical alteration in the prevailing economic values, such as might be wrought by a radical shift in trade patterns, or a radical change in the price of oil or gold or metals. Ten or fifteen or twenty years is a long time, and much can happen in a world that is changing as rapidly as this one.

Even if things in Europe should remain much as they are, it will still be true that, as the debts grow they will not only become more difficult to repay, they will also become more difficult to collect. The loans to the East bloc represent transfers of Western capital. We are depositing with the East a portion of our productive capacity, in exchange for promises of a portion of the future earnings of the capital. As the transfers continue, the question of the default becomes increasingly serious for the creditors. They have more to lose, and the debtors, if they escape their obligation, have more to gain. In the creditor nations, factions are created that represent the interests of debtors. The debtors suffer no such divisions.

We can see this happening already in the enormous pressures called up by the Polish debts. Among countries, those most entangled wish to continue lending, both for political and for economic reasons. Others wish to stop it now and begin to withdraw. Within countries, bankers have a point of view, exporting companies have a point of view, farmers have a point of view, foreign policy

makers have a point of view, and defense policy makers have a point of view. The interest of those who wish to carry on trading and lending are more focused and are represented more avidly. That is why the pipeline goes forward in West Germany at a feverish pace (300,000 jobs in that country now depend upon trade with the East bloc; Soviet "businessmen" now make sub-contracts directly with small suppliers, which do not know for which project they are working; neither does the German government know). That is why (the American State Department, under pressure from West Germany, wishes to amend the sanctions to allow export of a vital part for the pipeline).

When we began this policy of trading with and lending to the Communist bloc, our highest motivations were admirable. We wished to bridge the gap between East and West. We wished to bring prosperity and hope to oppressed peoples. We wished to begin a long process of converting tyrannical states into more moderate and, eventually, free entities. We wished to eliminate the awful danger of war. Now we have had almost a decade of experience with this method of achieving these lofty goals. Experience indicates the bankruptcy of the policy. The oppressed peoples are no less oppressed; the improvement in their standard of living is marginal. The tyrannical states have changed their character not one whit. The danger of war is if anything greater. We have gained no influence over the actions of the Soviet Union.

What we have managed to do is involve the Soviet Union and its allies intimately in our internal affairs, and in our relations with our own allies. It is we who are moving in their direction, not they in ours. If we are to stop this frightening tendency, we must do it now, while it is admittedly extremely difficult, but still possible. There must be no more loans. Our safety and our connections with Europe demand it.



The World in Perspective

Poland: One Defector's View

The imposition of martial law in Poland on December 13, 1981, sharply divided Western politicians and public opinion. What was the extent of Soviet involvement in the crackdown on the Solidarity labor union? Was Jaruzelski acting as a Polish patriot or a stooge of the Kremlin? On the whole, Europeans were much less inclined to be

concerned with the events in Poland than were Americans—but the European press did give major coverage to the statements of Leon Dubicki, a high-ranking defector from Poland, who was generally ignored in the American media. Dubicki consented to interviews in *Le Matin* and *Der Spiegel*, where he flatly contradicted the conventional view of the Polish crisis in the West. His opinions were barely discussed in the United States, however, even though Dubicki's information reportedly formed

the basis for the Reagan Administration's position on the matter. Dubicki claimed to have left Poland in August 1981 for a study trip to West Germany. He said that he held the rank of reserve general, and acted as a semiofficial adviser to the Defense Minister on strategic affairs. Dubicki challenged the following "perceptions" of events in Poland:

● **Polish leader General Jaruzelski acted as a free and reluctant participant in the crackdown.** Dubicki's characterization of Jaruzelski was hardly flattering:

He is morbidly ambitious. He is relentless. He is clever and at the same time lacks the ability to organize, think and consider in a complex, long term way. That is now very obvious. He is simply a gambler and a smart aleck. Just look at how he sat quietly for months like a wax figure in the Palatium and the Sejm. That clearly showed this man's complete lack of spiritual and, I would also say, intellectual depth. But at the same time he really has a talent for all kinds of intrigues and some settling.

Dubicki scoffed at Western hopes that Jaruzelski might become a Polish Tito. "There is certainly no chance of that. He does not have the qualities, authority or ability and certainly not the character to play that role. . . . He might pretend to, and people might help him to pretend to." Those people were, Dubicki made clear, the Soviets, who had also proposed that Jaruzelski be given the rank of army general.

Dubicki also claimed that Jaruzelski initiated and organized the putsch against Gomulka in 1970, and that Jaruzelski brought Gierek to Warsaw to act as a front man. On whether Jaruzelski really did refuse to shoot strikers and to use armed force in 1970 and 1980, Dubicki said: "That opinion is the result of the propaganda work carried out by the security services and the cells specially set up to shape public opinion. But it is a game."

● **The decision to move against Solidarity came because of the labor union's increasingly radical demands.**

Dubicki stated that he warned Solidarity of the danger in November 1980. When Jaruzelski became premier in February 1981, he said that he would crush Solidarity by force; the military had been preparing for the crackdown since that time. It was decided that, unless Solidarity were crushed by other means, the labor union would be forcibly destroyed at the beginning of winter.

● **The Soviet Union had no direct involvement in the imposition of martial law.**

Dubicki remarked that the Soviets used the specter of invasion at the beginning of September 1980 in order to retard the further development of Solidarity, and to allow the mapping out of more concrete plans for the use of Soviet and Polish troops. The Soviet troops were scheduled to be gradually infiltrated into Poland by December 15, 1980, although the Polish Army was scheduled to play the principal role. Dubicki believed that the USSR later

determined that such a direct occupation of Poland was neither necessary nor worthwhile. As for the events of December 1981:

Once again important statements are making mistakes. They are telling the Soviet Union not to intervene. They are warning it against invading and occupying Poland. These are naive mistakes. First, all that has existed for a very long time, it has all been planned, and from the viewpoint of command the Polish Army is fully integrated with the Soviet Army. I do not see any difference between Russian and Polish units as regards the execution of orders. The problem is really very different. They are plans which are already old. Do you think that all those exercises, which were carried out on such a large scale this year—the maneuvers—were carried out for fun? Do you think that the Soviet Union had several billions to throw away? Martial law is, so to speak, the result of those exercises and maneuvers. It is one point in a larger, well executed plan, and it is clear that the events in Poland are directed by the Warsaw Pact forces command.

It is also clear that all that had been unified for a long time. It was not a case of anybody forcing anybody. Everything was done willingly, because I see no difference between a Polish general, let's say Jaruzelski, and a Soviet general sitting beside him. There is no difference as regards their discipline and subordination to the supreme command.

● **The operation against Solidarity was primarily the defensive reaction of a fearful, tottering empire.**

In the most shocking part of his interview, Dubicki insisted that the existence of a free Polish labor union was not the major reason for the imposition of martial law, or for changes in the administrative structure of Poland. "The matter of Solidarity is a third-rate problem because the liquidation of Solidarity does not require the whole militarization of the economy, such as, for instance, the appointment of commissars for the administration and for big enterprises."

It is clear that there was a plan. It is necessary to destroy a myth which has spread in the West regarding Solidarity. The introduction of martial law was not absolutely necessary to crush Solidarity. It is simply a politico-military question: The secret mobilization of the armed forces, preparations for the militarization of Polish life, and the strategic and political preparation of a Polish corridor for possible actions on a larger scale. And the opposition was taken to liquidate Solidarity at the same time. But that is a secondary matter. Solidarity had no intention of seizing power. The Solidarity leadership had no ambition to hold political office. All that was artificially attributed to it to provide a cloak to cover politico-strategic aims. And Western Europe's fate is now being decided in Poland.

Question: So, Poland would be a corridor to the West?

Leon Dubicki: It is a corridor. It will always be a corridor, and it is in this corridor that the Soviets are now establishing order and establishing everything social, political, economic and military life—all on a war footing. It is clear that martial law may formally be lifted and that Jaruzelski is preparing for that possibility; but, even after the removal of martial law, Poland will really be a completely militarized country prepared for taking part in a possible war.

Dubicki added in passing that his dealings with Solidarity had been with the "leadership members, not Walesa the standard bearer, but members of the real leadership." (See *Grand Strategy*, 1 July 1981.)

● **The Polish Army is not a reliable instrument for suppressing the Polish people.**

Dubicki maintained that the soldiers would obey orders because of the coercion perfected in the socialist camp. They were committed to army discipline and exposed to the continuous influence of the party organization. Even though the average soldier was subject to indoctrination for only the period of his two-years of service, his political officers were very proud of being able to agitate the troops. The political officers used "moral terror, coercion, punitive instruments, and then the so-called honor of the uniform and the love for the authority of the army."

The soldiers are assigned in such a way, for example, that the ideologically more reliable man will keep an eye on the less reliable soldier. In addition, everyone must report on the other. In this way unreliable men are eliminated from the outset. In actions such as those you mentioned, therefore, a significant number of enlisted men stay in the barracks—entire battalions and companies. Some of the soldiers refuse to obey the order altogether; they are convicted and placed under arrest. There are a lot of officers and enlisted men under arrest in the Polish Army now.

Dubicki cited the 1970 Gdansk shootings as an example, because the soldiers used had been carefully selected beforehand, while unreliable soldiers remained in the barracks. He agreed that it was an illusion to believe that the Polish Army would oppose the Soviets in the event of an invasion. In the most recent crisis, troops were selected in March, "the criterion being whether or not they were prepared to fight against their own class, their own people."

● **The events in Poland mark the end of the Communist party as an effective instrument of political power.** Dubicki's answer:

The party's role is not vanishing. It remains. There is merely the problem of replacing leaders, but the apparatus remains. The party as such will continue to exist and to play the role it previously played.

Dubicki also asserted that the existing Soviet garrison in Poland of three divisions (most Western

estimates list two divisions) was enlarged by at least eight divisions plus logistics units. He did not say when these divisions were introduced into Poland, or how many remain. Dubicki acknowledged that there were Soviet soldiers in Polish uniforms guarding air fields, arms depots, communications facilities and other key installations inside Poland.

The Polish defector's interviews caused a stir in *Le Figaro*. The Paris publication cited German military sources on January 12 to the effect that five Soviet airborne divisions had been placed on alert, and that a large number of Il-76 *Candid* transport aircraft had been assembled at air fields in Moscow, Kammas, Pskov, Kiev and Vitebsk. *Le Figaro* also reported:

Yet another factor supports this hypothesis—a Rostock (GDR) newspaper has just reported the appointment of Soviet Admiral Vladimir P. Masov to the post of liaison officer between Warsaw Pact command and the East German navy. This function has hitherto been entrusted to a rear admiral of the lowest category, whereas Masov used to be the commander in chief of the Soviet Pacific Fleet in Vladivostok. If we rule out the possibility that that officer had been demoted for some political or disciplinary reason his task can only be to coordinate the East German, Polish and Soviet Fleets—the Red Banner fleet—in the Baltic. Such coordination had been envisaged in the event of an armed conflict with NATO. Indeed it is not the East German navy, a negligible quantity, which calls for a command post in Rostock, in the extreme west of the disposition of forces. And as far as Poland is concerned it could be watched from Kaliningrad.

Le Figaro claimed that the East German Army, which has a normal complement of 6 divisions, had called up 70,000 reservists in November 1981, bringing its strength up to 11 divisions. The East German administration was reportedly placed under direct army control, as was the administration in Poland.

This is what is called a "short circuit" which makes it possible to move directly to a state of war. At the top, the National Defense Council chaired by Party Secretary Honecker issues its orders to General Strelitz's Central Operational Directorate (ZEL). From the Council of Ministers to local administration all the powers are in the hands of "planning bureaus" consisting of officers bearing administrative titles corresponding to the military hierarchy.

Civilian officials sign documents ensuing from ZEL's directives. Titular holders of key positions sleep in their offices. A "state secretary for planning affairs" was created in 1961 with a view of ensuring a mobilization of this kind of the administration. The system was introduced 12 December, that is, when Helmut Schmidt was paying a visit to the GDR.

Retrospect and Prospect

Iran and the World

On December 15, 1981, *The Daily Telegraph* of London reported Turkish political and intelligence analysts had noted an increase in Soviet forces along the Iranian border. Additional mechanized brigades were said to have been moved into the area, and Category 3 troops replaced with combat-ready divisions transferred from the Chinese frontier.

Such news stories and rumors have been appearing since the fall of the Shah in January 1979, and particularly after the seizure of the American hostages and the outbreak of the Iran-Iraq War. And yet, despite its difficulties, despite its stumbling toward civil war or dictatorship or both, the Tehran government has managed to survive, and to develop working relationships with other nations. In its escape from international isolation, Iran may well be establishing a pattern of diplomacy that will define its place in the world for the next generation—if it is able to survive.

The Persian Gulf: Tradition and Revolution

In the early stages of the Iran-Iraq War, the military balance appeared to favor Baghdad's Saddam Hussein. Although Iraq did not win a quick and decisive victory, it was able to carry the battle to Iranian territory in the key oil producing province of Khuzistan (or, as Hussein would prefer it, Arabistan). The Iraqi army then went over to the defensive, presumably to minimize casualties, in anticipation of the disintegration of Iran under severe internal stress. (See *Grand Strategy*, 15 July 1981.)

Many observers today argue that Hussein's strategy has backfired, that Iran has managed to restore a sufficient degree of domestic order and military efficiency to gain the upper hand. They point to the successful Iranian offensive in late 1981 to retake Bostan, a city in Khuzistan less than three miles from the Iraqi border. This resurgence has led to pledges of increased support to Iraq from Jordan, Saudi Arabia, and some of the smaller Persian Gulf states, none of which want to see a strong Iran re-emerge from the revolution. The Soviet Union, too, seems to have strengthened its ties with Baghdad.

Not everyone is convinced that the tide has swung irrevocably in favor of the Iranians. Beijing's XINHUA news agency speculated in September that Iraq had decided to shorten its battlefield in anticipation of a protracted war. Hussein was said to be confident that his economy was much less affected by the war than was the Iranian and that his own international position was much the stronger.

XINHUA repeated this analysis in December.

Nevertheless, Iran seems to have gone over to the offensive throughout the region. Khomeini's brand of Shiite Islam is anathema to the Sunni rulers of Saudi Arabia and other Arabian states in the Gulf, particularly when he insists upon exporting it. But these states fear that Khomeini's so-called fundamentalism is actually a subterfuge for a revitalized Persian expansionism. Compare, for example, the statement of Iranian Prime Minister Amin Abbas Hoveida in January 1968,

As the most powerful nation in the northern coast of the Persian Gulf, Iran is naturally very much interested in the security and stability of this area. The imperial Government can protect, with utmost power, its interests and rights in the Persian Gulf and will not permit any country outside the region to interfere . . . Britain's exit from one door must not result in America's entrance from the other door or in British re-entry in a new form.

with that of Iranian Foreign Minister Ali Akbar Velayati in January 1982,

Yet as far as we are concerned, and it is necessary to remind the gentlemen of the states bordering the Persian Gulf, the fact exists that they should not forget that Iran forms the greatest and most powerful state of the region. We have the longest border on the Persian Gulf. If a security pact is to be created among the states bordering the Persian Gulf then, naturally, ignoring Iran is like hiding your head in the sand and pretending that you do not see what is happening.

We would like to remind the gentlemen . . . they will stand to lose more than anyone else. The continuation of their regimes and their economic welfare depend on the one single economic factor—oil. In order to derive financial benefits from their oil, they must be able to export their crude oil in an atmosphere of stability and calm in the Persian Gulf. If, on the other hand, the region is turned into a region of tension and instability, then it is natural to say that they will not achieve such an end and will not be able to continue with their quiet life.

On other hand, we, as a country with vast agricultural and economic resources, will be able to live without oil, but they cannot. We can live without the income from oil and with the support of the millions-strong masses. We can bear difficulties for a long time. But they should realize that if even one bullet is fired in the Persian Gulf, at the first instant they would be the ones deprived of a normal situation and their regimes would collapse onto

mutually.

Therefore, we believe that the Persian Gulf region must remain a region of stability and all the countries in the region should make the effort, join hands and prevent the creation of tension or fire which ultimately would benefit no one.

As the region's greatest country, Iran would assert the last word. Our country always has had the upper hand and will continue to maintain it. The fact is that we have repeatedly suggested to them and have said many things in common for cooperation and coexistence. There is no reason why tension should reign between us and the Persian Gulf littoral states. We say this because such tension benefits no one. But, unfortunately, they pay no attention. They are under the effect of U.S. influence and provocations.

One of the most obvious targets for Iranian pressure is Bahrain, a small but wealthy island state in the Gulf. Persia has a long-standing claim to sovereignty over Bahrain, based on the island's occasional submission to southern Persian provincial governments in the seventeenth and eighteenth centuries. The Shah regularly listed Bahrain in Iranian publications as a province of the Persian empire, and Iran's parliament (the Majlis) passed legislation from time to time that purported to apply to the island. When the Shah resumed his claim to Bahrain in 1970, the religious and conservative sections of Iranian society—those which would subsequently support Khomeini—strenuously objected to the surrender of Iranian sovereignty.²

In mid-December 1981, Bahraini officials announced the arrest of 60 alleged saboteurs with Iranian connections. (Of these, 45 were Bahrainis, 13 were Saudi nationals and there was one each from Kuwait and Oman.) An arms cache was also seized, which included six French-made machine guns, four Soviet-made handgrenades, a pistol and some ammunition. The Bahraini government claimed that these arms had been smuggled from Iran, and that a number of the saboteurs had received military training in Iran. The French weekly magazine *L'Express* reported that five Iranian hovercraft loaded with troops and equipment were standing by to assist the terrorists in a coup attempt. The hovercraft were said to be stationed at the Iranian port of Bushahr.

This supposed Tehran-sponsored subversion was quickly condemned by Saudi Arabia and the Gulf Cooperation Council. The GCC had reportedly been discussing the development of a cooperative air defense in the area, partly in reaction to Iran's occasional air strikes against Kuwait's territory. On the other side of the peninsula, the Iranian charge d'affaires in North Yemen was expelled in late December for distributing subversive literature. On January 12, the Israelis claimed that the North Yemenis had discovered an Iranian ex-

pionage and sabotage ring, and had arrested some of its members.

In addition, to its underground activities in and around the Gulf, Tehran had sought to overcome the international isolation that has resulted from the revolution, the American hostage crisis, and the war with Iraq. Its most prominent Middle Eastern supporters have been Libya, South Yemen, and Syria. Libya has provided Iran with its largest external source of arms, and has agreed to cooperate with the beleaguered Iranian oil industry. Syria has supposedly allowed landing rights for Iranian military aircraft after they complete missions against Iraq. Outside the immediate region, several Iranian delegations have visited India in the past year, including Iranian Minister of Housing and Urban Development Mohammad Shahab Ghassemlou in October 1981.

Tehran's relationship with Turkey, which is a potentially valuable corridor for resupply, has been unsteady. Ankara has close economic ties with Libya, but of late has also been quite cooperative with Iraq. The Turkish Foreign Ministry has been forced to deny Iranian allegations that military units were being formed in eastern Turkey by opponents of the revolution, particularly those who supported a restoration of the monarchy. Their common border area has been a sensitive one, and there has reportedly been sporadic fighting along the boundary as Khomeini's revolutionary guards have pursued Kurdish rebels into Turkey.

Despite this friction, trade negotiations have continued. In September, the Turkish province of Agri and the Iranian province of Western Azerbaijan signed a border trade agreement, in which Iran exchanged 950 tons of oil daily in return for 120,000 head of livestock annually, plus leguminous plants, sugar and margarine. And in November, a Turkish technical and economical delegation visited Western Azerbaijan and Tehran.

The Arms Connection

One of Iran's greatest weaknesses in its war with Iraq has been its inability to gain secure supplies of arms and spare parts. Most of the Iranian military is equipped with American armaments, including a great deal of sophisticated hardware such as the F-14 aircraft, and Tehran has closed the door to resupply from the United States. Some American-made equipment may have been channeled to Iran from North Korea, which itself obtained the materiel from Vietnam. Libya has also been a major supplier, drawing upon its immense arsenal obtained largely from the USSR and France. But the most intriguing link in the Iranian arms connection, and the most shadowy, has been that with the parish of the Middle East, Israel.

Tel Aviv's *Haaretz* reported in August that a number of Israeli firms had resumed their shipment of non-military exports to Iran at a rate of \$40

² This account taken from J. B. Kelly, *Arabia, the Gulf and the West* (New York: Basic Books, 1980), pp. 54-55, 315.

million dollars per year. (This was approximately one-third of the pre-revolutionary level of transactions.) These products were marketed to Iran through Israeli-owned affiliates in Europe, usually via Rotterdam or Italian ports. The most controversial issue involves the Cypriot airfield at Larnaca, from which Israeli-sponsored aircraft are allegedly re-directed to Tehran. An Argentinian transport aircraft that crashed in the southern USSR under mysterious circumstances during the summer of 1981 was supposedly engaged in this route. The Icelandic carrier "Carino-Lux," a subsidiary of Iceland Air and Loftleider with central offices in Luxembourg, has also been linked in the Israeli press to arms shipments to Iran.

The amount of this rumored Israeli assistance is undisclosed, at least in open sources. *The Economist* of London reported that 250 tons for Iran's American-made F-4 Phantoms were shipped from Israel in October 1980, along with 300 tons of tank spares and ammunition in July 1981. Iraq claimed in August 1981 that Iran and Israel had concluded an agreement for 400,000 artillery shells, using a British company as an intermediary.

Tehran has also been forced to deal on the open market for arms, with mixed success. In April, the Iranians admitted that they had lost \$56 million dollars in a swindle while attempting to purchase arms in Paris via Madrid. (There were unconfirmed allegations that Iranian representatives in Europe had embezzled the money.) Two months later, the Brazilian firm Engasa (Specialized Engineers, Inc.) denied that it had arranged the shipment of \$56 million of Brazilian weapons to Iran through the Consultores Gerais Company. Engasa blamed Israeli sources for starting the rumor.

Iran and the Eastern Bloc

Iran's contacts with the Soviet Union and the Eastern bloc are not a new phenomenon, but this relationship has taken on much greater importance given the Khomeini regime's hatred for the West. Its closest ties in the communist world are with Yugoslavia, Romania and North Korea—nations that are generally believed to enjoy a certain degree of independence from Moscow, but that often provide the USSR with an alternate means of influence.

Romania's expertise in the petroleum field is a natural source of interest to Iran, whose own oil industry is reportedly in a shambles due to the withdrawal of American technicians and the war with Iraq. A large Romanian delegation visited Iran in October 1981 for talks on energy, machinery and trade. The Romanians also indicated an interest in cooperation and joint planning in water and electricity projects. A Yugoslav delegation, led by the Vice President of the Federal Committee for Energy and Industries (Hasan Siljak), visited Iran a few weeks later and expressed similar interest. The Yugoslavs agreed to purchase 700,000 tons of oil in 1981 and 1 million tons in 1982 from Iran. The Belgrade dele-

gation also proposed to put the unused capacity of its oil refineries at Iran's disposal, allowing the Iranians to process their oil in Yugoslavia and then transfer the product back to Iran, or sell it to other countries. The total trade between Yugoslavia and Iran, which amounted to \$180 million in 1980 and \$300 million in 1981, is expected to expand to \$500 million this year. In January 1982, the Yugoslav "Energoimport" company of Sarajevo signed a contract with the Iranian Ministry of Energy to deliver \$5.4 million worth of equipment for a power transmission line near Shiraz, in southern Iran.

Also in January, Tibor Melega, the Deputy Director of the Hungarian Ministry of Foreign Trade, headed an economic delegation to Tehran. (The Iranians indicated an interest in discussions about agriculture, power transmission, chemicals and railroads.) In late 1981, Iran had dispatched delegations to East Germany, Yugoslavia and Czechoslovakia. The Czech visit was intended to purchase spare parts, while the East German meetings produced an agreement by the Germans to fund a power distribution network in Iran's Gilan Province.

The Soviet Union, which has been supplying the Iranians with arms through nations such as Poland, Libya and Yugoslavia, may also be the source for East German, Syrian and North Korean military assistance to Iran. The USSR has reportedly also sent light arms and ammunition to the Iranian revolutionary guards at Tabriz, although much of these shipments are diverted instead to anti-Khomeini insurgents. According to British press accounts, the Iranian government has agreed to accept the assignment of about 75 Soviet and Cuban military and intelligence advisors, some of whom work at a large training camp for revolutionary guards at Mashhad.

The Khomeini regime accepts such Soviet assistance, although it claims not to be pro-Soviet. As Iran's ambassador to the USSR, Mohammad Mokri, explained in September: "The Soviet Union more or less approves of the revolution but stresses its anti-imperialist aspect. We have explained time and time again that there is also the Islamic aspect, forming an inseparable part of the revolution, in addition to its spiritual, moral, anti-American and anti-monarchical features."

Whatever Tehran's intentions, the Soviets have continued to build upon the relationship that they had established with the Shah. The capacity of the joint Esfahan steel mill project, for example, has been increased from 500,000 tons to 1.9 million tons annually. The Soviets have also participated in the construction of large power stations in Esfahan.

Among the Soviet equipment recently ordered by the plant is a five-story, 200-ton steam boiler from a Soviet factory in Belgorod, the transportation of which required 17 railroad cars. Another boiler has been ordered for the plant by Iran's Tavakoli company. Some Iranian technicians have been trained

in the USSR; others received schooling from a number of training centers established by the Soviets in Iran, such as the facilities at Esfahan, Arak, Kerman, Hamedan, Zanjan, Qom and Rey. Each center is able to accommodate up to 500 students, and another 10 centers will be constructed in the near future.

The pace of Soviet-Iranian contacts appears to have increased in the past few months. In September 1981, the Soviet ambassador to Iran met with the Iranian Energy Minister, at which time the Soviets were asked to resume their work on Ahvaz's Ramin power station, which is being constructed by the Soviet company Tekhnopromeksport. The Soviet ambassador agreed. The following month, a delegation from the Iranian news agency held talks on mutual cooperation with the Soviet news agency TASS.

Among the most notable areas of Soviet-Iranian cooperation have been transportation and communications. Iran's first electrified railway has been completed between Tabriz and Jolfa, with the aid of Soviet specialists. Both nations expect that this line will allow a considerable increase in the volume of goods exchanged. A new line between Mashhad and Sarkhs is being designed, as is a bridge over the Soviet-Iranian border river, which (according to Radio Moscow) "will also enable the Islamic Republic to have contact and commerce with the countries in Southeast Asia and Japan via the Soviet railway system." The Soviets have sent experts to Iran to maintain 10 Soviet-made diesel locomotives operating in the Tabriz-Tehran route; Iranian railway technicians, in turn, are being trained in the

USSR by "Tekhstroyexport."

Iran's exports to and through the Soviet Union in the past year have doubled, according to Soviet sources. This cargo travels primarily to such Caspian Sea ports as Baku, and then it is conveyed either by railroad or via the internal Soviet waterways, through ports such as Kerch on the Black Sea. This arrangement was codified by a transit pact signed in Moscow last September.

The West is concerned that, once Khomeini dies, civil war will break out in Iran, and that the Soviet Union will use its assets in Iran at that point to control the situation either directly or indirectly. The pro-Soviet Tudeh party, for example, is now said to hold up to 40 percent of the key positions in Iran's press, radio, and television, as well as the central bank, the national oil company and important government ministries—despite the regime's public hostility toward communism. In November, the leader of the Tudeh party (Nouredin Kia-Nouri) was reportedly moved from Tehran to Moscow, from which he could play a role in Iran similar to that of Babrak Karmal in Afghanistan.

It is also possible that Iran will survive as a nation under a religious or military dictatorship. A strong Iran would threaten the status quo in the Persian Gulf, as it did under the Shah, but without the Shah's generally pro-American stance. In either case, neither the disintegration nor the reintegration of Iran is likely to favor the interests of the United States, nor of its few friends in the region. This in itself is a victory for Soviet policy. The degree to which Moscow will be able to capitalize on this advantage remains to be seen.

The Editorial Board of *Grand Strategy: Counter-currents* includes: Editors, Patrick J. Garrity and L.P. Aron; Executive Editor, Harold W. Rood; Contributing Editors, Stephen Cambone, Christopher Hamner, Thomas B. Silver; Cartographic Illustrators, N.L. Diaz; Editorial Advisers, Jack D. Crouch III (University of Southern California),

Christopher C. Harmon (Claremont Graduate School), Steven A. Maaranen (Los Alamos Scientific Laboratory), Peter W. Schramm (Intercollegiate Studies Institute). Editorial correspondence is encouraged, and may be sent to Editor, *Grand Strategy: Counter-currents*, 201 West Fourth Street, Claremont, California 91711, 714/621-5831.

THE WALL STREET JOURNAL

FRIDAY, MAY 7, 1982

REVIEW & OUTLOOK

Poland: Declare the Default

By ROBERT W. KASTEN JR.

Nearly five months have passed since the Soviet-backed imposition of martial law in Poland. Four thousand Poles have been detained without an accounting. Lech Walesa remains in confinement, movement toward democracy has been crushed and Stalinistic repression continues. Yet even the brutality of martial law can't stop the Poles from fighting for a say in the way their country is run.

Tens of thousands of demonstrators are openly defying the martial law authorities by staging pro-Solidarity rallies in the streets of Warsaw, Gdansk and other cities. Protest marches erupted in violence on May 3 when demonstrators were beaten and tear-gassed by riot police. Radio Solidarity continues to broadcast, and Solidarity activists will continue to press their demands for political and economic reform.

The U.S. can no longer stand idly by while the Polish people battle for political and economic freedom. We have been unable to persuade our NATO allies to join us in imposing tough sanctions against the Soviets and the Polish military regime. Many members of Congress now believe we have waited long enough. It is time for the U.S. to stand up for Poland by declaring the military government in default and cutting off credit to the Soviet bloc.

Try to Break Down Communists

The crisis in Poland provides an unprecedented opportunity to hasten the breakdown of the Soviet Communist system. The bankruptcy of Poland, and the economic troubles of Romania and other Soviet-satellite countries, couldn't have come at a worse time for the USSR.

Analysts expect the prevailing world price for oil to stabilize at about \$30 per barrel and stay there during 1982. That translates into a serious \$6-per-barrel drop in oil sales revenue for the Soviet Union,

Such a decline in oil prices could unsettle the Soviet economy at any time under any circumstances, but this year its impact is bound to be more severe because of other Soviet bad news: poor grain harvests for the past three years, a low world price for gold and weaker demand for Soviet goods due to the economic slowdown in the West.

If we cut off credit to the Soviet bloc, we will force the Russian leaders to pay the full price for the Communist system they have imposed on their own people and those of Eastern Europe. What we are witnessing is not the bankruptcy of Poland; it is the failure of the Soviet-style economy. A continuing supply of Western credit is shoring up this unworkable system, preventing necessary and fundamental economic reforms. The West has won the economic battle—why continue to pour money

The United States can no longer stand idly by while the Polish people battle for political and economic freedom. It is time for the U.S. to stand up for Poland by declaring the military government in default and cutting off credit to the Soviet bloc.

down the Communist sinkhole to subsidize the Soviet empire?

Yet our NATO allies seem eager to continue subsidizing East-West trade. U.S. Under Secretary of State James Buckley was essentially ignored when he traveled to Europe in quest of a tougher allied

stance toward credits for the Soviet bloc. West Germany has approved \$517 million in new Soviet export credits since January, despite its denunciation of the Soviets for their role in the Polish crackdown. Construction of the Siberian natural-gas pipeline, which is being built with Western credits and which will supply the Soviets with approximately \$8 billion a year in hard currency when completed, is going ahead as scheduled. As far as our allies are concerned, it's back to business as usual.

At the very least, what has happened in Poland should force us to reconsider the value of our trade and economic relationships with the Soviet bloc. Extending the benefits of expanded trade was supposed to depend on the Soviets' "good behavior." The Soviet Union has certainly benefited, using its East European allies as a conduit for Western goods and technology, essentially forcing those countries to absorb the hard currency debts that the Soviets would otherwise be compelled to pick up.

The Soviet gross national product is only 60% as large as ours, but the Soviet investment in arms has been much larger—exceeding the U.S. investment by 80% to 90% during the last five years. It's no coincidence this buildup occurred during "detente," when the West supplied the Soviet bloc an estimated \$80 billion in credits.

U.S. Should Do What Is Right

When Poland's debt payments were stretched out in April of last year, the NATO allies included a so-called "tank" clause, calling for a declaration of default in the event of "exceptional circumstances" such as internal repression. These "exceptional circumstances" have now occurred, and Poland has fallen behind in payments to almost all its Western creditors. The trade that was intended to bind East to West "with hoops of gold" is binding our own hands instead.

The Polish government argues it cannot make payments on its debts to the West until we grant additional credits. It's fair to say that the pro-Solidarity marches taking place in Poland are one of the few things preventing some of our allies from jumping in. Western banks have yet to reschedule Poland's 1982 debts. They are waiting to see what position Western governments will take.

The current demonstrations could prove a turning point in Poland's political and economic crisis, and in U.S. foreign policy as well. Time after time—Czechoslovakia in 1968, Afghanistan in 1979—we have let ourselves become so worried about allied reaction to tough sanctions that we failed to do what was right. Now a new administration has a chance to reverse this foreign policy trend, to restore America's credibility, to weaken the Soviet economic system, to help the Polish people, to lead instead of following. Now is the time to declare Poland in default.

Mr. Kasten is a Republican Senator from Wisconsin.

SUBCOMMITTEE RECESS

The subcommittee stands in recess until 9:00 a.m. tomorrow.
[Whereupon, at 12:35 p.m., Tuesday, May 17, the subcommittee was recessed to reconvene at 9 a.m., Wednesday, May 18.]

INTERNATIONAL MONETARY FUND QUOTA INCREASE

WEDNESDAY, MAY 18, 1983

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 9:20 a.m., in room SD-192, Dirksen Senate Office Building, Hon. Robert W. Kasten, Jr. (chairman) presiding.

Present: Senator Kasten.

NONDEPARTMENTAL WITNESSES

INTRODUCTION OF WITNESSES

Senator KASTEN. The subcommittee will come to order.

This morning we will continue our hearings on the International Monetary Fund quota increase request with testimony from non-governmental witnesses.

Our first witness is Paul Craig Roberts of the Center for Strategic and International Studies, Georgetown University.

After Mr. Roberts gives his testimony, we will have a three-member panel consisting of Jack Pierce, treasurer, the Boeing Co., on behalf of the U.S. Chamber of Commerce; Philip G. Moon, senior vice president, National Bank of Detroit, on behalf of the Bankers Association for Foreign Trade; and George J. Clark, executive vice president, Citibank.

It is good to have you with us. Your full statements, as you know, will be made part of the record. We would appreciate it if you would summarize your statement if possible.

I thank you for joining us this morning.

GEORGETOWN UNIVERSITY

STATEMENT OF PAUL CRAIG ROBERTS, PROFESSOR OF POLITICAL
ECONOMY, CENTER FOR STRATEGIC AND INTERNATIONAL STUD-
IES, GEORGETOWN UNIVERSITY

IMPORTANT ASPECTS OF QUOTA INCREASE

Mr. ROBERTS. Thank you, Mr. Chairman.

My statement is submitted for the record. I will have to leave by 10 or 10:15, so I will just briefly cover a few points, then we can have whatever discussion you may like.

I would like to begin by saying that my testimony should not be misconstrued as anti-International Monetary Fund or anti-big banks or anti-Third World debtor nations. I am concerned though that some important aspects of this quota increase are being overlooked.

I think if you remember, both the Department of the Treasury and the President were opposed to a 50 percent quota increase for IMF until the question of default and bank failure arose. What we have happening is rather unusual, that a quota increase for IMF is going through not only on its own terms, but under the guise of a bailout either of banks or of debtor nations.

This is a big change in approach to the arguments for an IMF quota increase. I am afraid it carries the risk of dropping important international institutions and may carry the implication that it will ultimately turn the International Monetary Fund into an aid-giving agency.

COST TO UNITED STATES

I would like this morning to point out some of the costs of the quota increase, particularly given the reasons that have been moved forward. One is cost to the United States. An IMF quota has to be financed in our credit markets such that it is equivalent to a larger Federal deficit.

So, whatever gain you make in reducing the deficit by curtailing domestic expenditures or cutting the defense budget or even by raising taxes, these gains, hard won, are offset in their credit effects by the necessity of financing the IMF quota increase.

I would point out that the effects in the capital market are larger than the \$8.4 billion which makes up our total commitment to this new IMF expansion. They are larger than that according to the recent testimony of Secretary of the Treasury, Donald Regan, if the numbers are correct.

He said that in 1977 to mid-1982 our private banks lent \$4.3 abroad for every dollar in IMF loans. If that ratio continues to hold, you have the total effect on our credit markets of a \$75 billion drain from domestic purposes.

So that at a time when the President's own domestic economic program is in danger because of the concern with deficits, this is quite a substantial effect, \$75 billion effect on the credit markets.

Now, another cost to the United States in this particular quota increase is that it sets us up basically in a situation where we are going to be pressured to have this whole process turned into one in which we make international transfer payments.

We can't fund our domestic transfer payments at the current time and the risk of sort of acquiring larger commitments in the sense of making international transfer payments through IMF to underwrite these debtor nations' deficits which might become permanent would be a large additional permanent commitment. I will say something more about that.

COST TO IMF

Second, I will point out the cost to the IMF. I have mentioned risk in making them an aid-giving agency and putting them in a

position where they may have to permanently underwrite country deficits. I will say a little more about that.

COST TO DEBTOR NATIONS

Third, let me mention the cost to the debtor nations. If they already have more debt than they can service, the bailout simply loads them up with more debt. So if they can't service the existing debt, and that is one of the reasons we have the crisis, it is not clear how they are being helped by giving them a larger debt service.

CONDITIONALITY

The IMF austerity programs or the conditionality imposed as part of these loans falls heavily on the private sectors of these countries. It raises some questions about whether or not on a large scale we have so many countries in trouble that the IMF conditionality can work.

General requirements usually are that a nation has to reduce its imports and expand its exports in order to acquire some surplus so that it can eventually service and retire its debt by surplus export earnings. When you have a situation of a large number of countries in difficulty, it is hard for all of them simultaneously to reduce their imports and expand their exports.

In the case of Brazil now, if you note recently in the news some of their major trading partners, Argentina, Nigeria, and Mexico, are also under pressure to reduce their imports and expand their exports. So there you have a situation where it is very difficult for that to work out. Therefore, the austerity which generally falls on the internal private sectors of those countries has certain risk of economic and political destabilization.

COST TO BANKS

Fourth, I would like to mention the cost to the banks. The reason for the crisis for them is that they are already overexposed in these countries, and yet the IMF bailout packages require that they increase their exposure.

For example, going from memory, the Brazilian bailout package required the banks to roll over about \$4 billion in existing loans, to add about \$4 or \$5½ billion of new loans, \$10 billion of new trade credits and to keep a certain large sum on deposit in Brazilian financial institutions.

So, the effect of this is basically to increase the debt burden to those nations and to increase the exposure of the banks. The problem is that the people have already more debt than they can service and more exposure than they should have.

Another cost to the bank I think of this particular quota increase which is being moved forward for the sake of bailout of the debt situation is the public perception that somehow the Government is going to bail out the big banks at a time when other sectors of society are suffering from recession. I think this is a costly thing.

To sum this up, when you pile debt upon debt you risk that ultimately the only way out with everyone's prestige involved, the

banks, IMF, the White House, the Treasury, the Federal Reserve, Congress, the only way out of piling debt on debt is resurgence of the world inflation.

When people get their prestige committed they don't want the ship to sink. It would generate a rise in commodity prices which makes it possible for the debtor nations to service these loans, at the same time depreciate the real value of the debt.

Therefore, it may well be that the solution that is being adopted is more likely to lead to a crisis than the problem itself. The solution tends to weaken all institutions that are involved.

There may be other better solutions which would have the effect of reducing the debt burden of the debtor nations and reducing the exposure of the private banks. I think that that approach does not receive much thought, and there is a great deal of rhetoric about a crisis which generates a certain amount of panic.

As Bill Simon said, if I can find the quote: "When fear comes in, reason departs."

This whole discussion of this has suffered to some extent from fear, and I believe that we have to consider that the proposal may be heir apparent to a large crisis in the future, as well as a thrust in the very heart of distinguished international institutions.

With that, Mr. Chairman, I will conclude my remarks.

[The prepared statement of Mr. Roberts follows:]

PREPARED STATEMENT OF PAUL CRAIG ROBERTS

William E. Simon Professor of Political Economy
Center for Strategic and International Studies
Georgetown University

Mr. Chairman, members of the Subcommittee on Foreign Operations, I am pleased to give you my views on U.S. participation in the eighth quota increase of the International Monetary Fund and the expanded facilities of the General Agreement to Borrow.

An atmosphere of crisis is being used to urge U.S. participation in yet another expansion of funding for the IMF and the scope of its activities. Policymakers have stressed in testimony before Congress (for example, Paul Volcker, House Banking Committee, February 2, 1983) the pressures on the international financial system and the implicit risks should foreign governments slide into default on their loans to our banks. Federal Reserve chairman Paul Volcker recently called the crisis "a threat to the recovery, the jobs, and the prosperity of our own country, a threat essentially without parallel in the postwar period."

As a result of this kind of rhetoric, a seriously mistaken attitude is forming that a quota increase to finance an IMF-led bailout of debtor nations and their creditors is all benefit and no cost. In my testimony today I would like to bring out the following points:

- (1) the IMF's rapid growth in recent years did not prevent the current crisis, and its further growth does not preclude a future crisis,
- (2) the alternative to an IMF bailout is not default, but a rescheduling or at worst a partial write down of some of the loans,
- (3) if a bailout is nevertheless deemed desirable, there are alternatives to conducting it through the IMF, and
- (4) there are real costs to the U.S. economy, to U.S. diplomatic

and financial influence and, perhaps, even to our national sovereignty of participating in the IMF bailout.

The Rapid Growth of the IMF

Normally, an IMF loan is supposed to be a bridge loan to provide balance-of-payments financing for countries whose imports temporarily exceed their exports. More recently, however, the IMF has taken an expanded view of balance-of-payments problems and has made investment loans to countries for "structural adjustment." These loans are supposed to allow countries to increase their exports by investing in ports and industrial projects and to reduce imports by investing in domestic energy projects. Money, of course, is fungible, and a \$5.5 billion "structural adjustment" loan to India in 1981 was followed by large Indian arms purchases from France.

The IMF's ability to add "structural adjustment" loans to its product line reflects the rapid growth of its funding and statutory lending obligations. In 1978 IMF quotas increased 50 percent from 40 billion to 60 billion special drawing rights (SDRs). The same year the maximum credit lines of member countries almost doubled, increasing from 2.5 to 4.5 times their quotas.

The result was a jump in IMF statutory lending obligations from 100 billion to 270 billion SDRs. This in turn led to a demand for additional IMF funding to meet the needs implied by the larger lending obligations. If the approximately 50 percent quota increase takes place in 1984 as planned, the statutory lending obligations of the IMF will expand to about 400 billion SDRs or about \$440 billion at the current exchange rate of 1 SDR = \$1.10, and the IMF will have enlarged its scope of activity as a world central bank charged with maintaining the liquidity of the international financial system.

Despite the IMF's rapid growth--or perhaps because of it--numerous debtor countries including some oil exporters cannot today repay principal and interest on their loans. One of the reasons is that in recent years debtor countries' loans

have been growing faster than their export earnings. The willingness of banks to lend so much may reflect a feeling of security provided by the IMF's presence. For example, on February 2, 1983, Paul Volcker told the House Banking Committee that the availability of IMF funds "provides a base for attracting commercial bank and other financing."

Further growth in the IMF in order to finance a bailout does not preclude a worsening of the crisis. The crisis exists because debtor nations already have too much debt and because our banks have too much exposure. For example, our nine largest banks have lent 222 percent of their total capital to the non-oil-producing developing countries. The same banks have 112.5 percent of their capital exposed in just three countries--Argentina, Brazil and Mexico.

The IMF bailout packages require additional lending by the same private banks that are already over-exposed. For example, the terms of the IMF's bailout of Mexico require Mexico's creditors to increase their exposure by \$5 billion. Administration spokesmen such as Secretary of State George Shultz have described the policy as bailing our banks in rather than out, and he has described it as "our objective" to get the banks in deeper.

It is the wrong objective. The result is to load up debtor countries with more debt and to worsen the exposure of the private banks that are already at risk. It is not for certain that this is a solution. It could be throwing good money after bad and result in a worsening of the crisis. The main achievement of the bailout might be to pass a sinking ship on to someone else's watch.

Alternative to a Bailout

One alternative to a bailout, which increases the debt of the borrowers and the exposure of the lenders, is for the banks to reschedule and stretch out the loans or, if necessary, to write down whatever fraction of the loans it takes to make the remainder good. In other words, the alternative is to reduce the debt burden on debtors to levels that can be serviced. It would require the banks to sacrifice some part of the earnings that

were anticipated from the loans, and bank dividends, stock prices and bonuses to management would fall, but the banks wouldn't.

The banks should be aided in the adjustment by being allowed a larger tax-deductible loan loss reserve. Currently banks are only allowed a reserve of 1.0 percent of their loans, and this year the IRS in a short-sighted grab for revenues is reducing the the tax allowable reserve to 0.6 percent. George Champion, the former chairman of Chase Manhattan Bank, believes that the allowable loan loss reserve should be at least 3 percent and in the current circumstances 5 percent. There is no doubt in my mind that he is right. If the banks currently had reserves of 3-5 percent of their loans, there would not be a crisis.^{1/}

Managing the Bailout Without the IMF

If for some political or other reason a bailout is deemed necessary, there is no obvious reason for conducting it through the IMF. Since most of the IMF's resources are provided by the U.S. and its allies, there are no financial reasons to prevent the Western alliance from organizing the bailout itself and extracting political and strategic benefits on a quid pro quo basis. If the problem of foreign borrowers is only one of cash flow, as is claimed, a self-liquidating revolving fund could be set up to tide over the debtor countries. When the crisis is over, the participating countries could withdraw their funds for their own use because they would not be permanently transferred to the IMF.

It might be argued that the bailout should be conducted through the IMF because its staff has the expertise to help manage the domestic economies of the borrowing countries and return them to health. Unfortunately, the typical austerity that the IMF imposes on a troubled borrower--measures designed to force a reduction in imports and an expansion of exports in order to build foreign exchange reserves--cannot be conducted in the aggregate. One or a few countries could improve their ability to service their loans through such policies. However, currently there is a large number of borrowers in difficulty,

and it is not possible for all of them to simultaneously increase their exports and reduce their imports. Most likely, if the bailout proceeds through the IMF, one casualty will be the vaunted IMF "conditionality."

Costs to the U.S. of the IMF Quota Increase

Advocates of the bailout claim that the quota increase is an asset swap between the IMF and the U.S. Treasury with no economic or financial cost to the U.S. This claim is incorrect. From an accounting point of view an IMF subscription is a swap of assets, though one few prudent men would make. Once Congress passes an (off-budget) appropriation, the Treasury issues the IMF a letter of credit in dollars equal to 75 percent of the subscription. The remaining 25 percent is paid in dollars, other hard currencies or SDRs from Treasury holdings. In exchange the Treasury receives a claim on the IMF.

Although treated as an asset swap, there is an economic cost to the U.S. The Treasury gives up liquid assets having immediate command over real resources for illiquid or dormant reserve assets denominated in SDRs. The Treasury cannot withdraw large amounts of SDRs and spend them, and it could not borrow from the IMF in amounts anywhere near the size of its quota. Therefore, the U.S.'s asset position in the IMF is substantially inferior to Treasury's cash balances or swap lines with foreign central banks.

As the IMF draws on its line of credit, the Treasury has to cover it by borrowing in the financial markets. (With the present debt problems of debtor countries, the line of credit is likely to be drawn down rapidly to finance the bailouts.) A quota increase is equivalent to a larger deficit, because the U.S. has to finance it by borrowing in the credit market. The total impact on the credit market is greater than the \$8.4 billion quota subscription and GAB contribution, because the IMF bailout packages require additional lending by U.S. banks, thus reducing their ability to purchase U.S. government and corporate bonds.

The borrowing necessary to finance the IMF quota increase and GAB contribution offsets dollar for dollar any reductions

in Treasury borrowings achieved by cutbacks in defense or domestic programs or by raising U.S. taxes. It is a straight resource transfer from U.S. purposes to IMF purposes and as such is equivalent to a higher tax on American incomes.

In testimony before the Joint Economic Committee on January 27, Federal Reserve chairman Paul Volcker warned that there is not enough credit to go around and that unless federal borrowing is reduced, higher U.S. interest rates will work against the economic recovery. Clearly, in Mr. Volcker's mind the cost to the U.S. of a larger IMF quota is either higher interest rates and a weaker recovery or higher taxes or reduced defense and social spending. These costs are being discounted by the same U.S. policymakers who are responding to the federal deficit by trying to force President Reagan to abandon his supply-side tax policy and to cut his defense program.

A quota increase would also reduce the interest income stream on Treasury assets, because interest payments on IMF reserve holdings amount to only 85 percent of the weighted average of market interest rates of the SDR component currencies.

Some people claim that an IMF quota increase helps our economy because it gives foreigners money with which to buy our products. This argument stands in total contradiction to IMF conditionality which requires debtor countries to reduce their imports. Furthermore, if the argument were true--it is not--instead of increasing the quota 50 percent, we should double it or increase it ten fold or a hundred times.

In addition to the economic costs there are other costs. At best the bailouts of the foreign countries are a form of foreign aid; at worse they are international transfer payments from "rich" nations to "poor" nations, from North to South, from the West to the Third World. By handling the bailouts through the IMF we are allowing a third party to disburse our money for us, thereby enfeebling our diplomacy. Passing foreign aid through an international bureaucracy reduces the control and influence of the donor countries. The ultimate result is to divorce foreign aid from the policy interests of the

U.S. and the NATO alliance. There is no obvious reason why the U.S. should use its scarce resources to increase the power of the IMF, a supranational organization that we do not control.

Prior to the sudden emergence of the default crisis, the U.S. Treasury and President Reagan were resisting the Third World's pressures for a large increase in IMF quotas, which implies that, the crisis aside, there are good reasons to resist further rapid growth of the IMF. And there are. By responding to demands for money we legitimize the chorus of voices that holds the U.S. responsible for Third World poverty, world recession and the inability of developing countries to repay their loans. A country cannot continually respond to aggressive demands with concessions without losing its sovereignty. The IMF, which under Bretton Woods dealt with temporary balance of payments problems, is in danger of being turned into a mechanism through which the West makes transfer payments to the Third World. The IMF quota subscriptions are a de facto tax on the American people. Perhaps in the past the tax was better disguised, but today it is clear enough. At a time when the U.S. is forced to cut back on its own domestic transfer payments, the Congress is expected to pass an \$8.4 billion off-budget appropriation for the IMF.

The evolution of the IMF into an institution that makes permanent resource transfers from the West to the Third World is perhaps implicit in the structural organization of the IMF, which allows the U.S. and its allies a voting share that is considerably smaller than their contributions in real resources.

In principle each member country's voting share and credit line is proportionate to its stated quota, which purportedly reflects the member's relative weight in the world economy. However, in practice the U.S. has contributed about twice as much in real resources as it has voting weight in the IMF. The disparity results from the fact that only 25 percent of each member's quota is required to be paid in convertible currencies and SDRs acceptable as means of payment in international

settlements. The remaining 75 percent can be paid in members' own currencies. The result is that only those countries whose currencies are convertible contribute in terms of command over real resources 100 percent of their quotas; the others contribute only 25 percent. The hard currency nations of the U.S., Western Europe and Japan contribute the bulk of the IMF's resources, but their voting share and power are diluted by the voting share allotted to the countries with "unuseable currencies" that account for about 50 percent of the IMF's total stated quotas.

Consider, for example, the eighth quota increase under current consideration. Leaving aside the General Agreement to Borrow, the U. S. quota increase is about \$6 billion, which is about 37.5 percent of the approximately \$16 billion in useable currencies that will accrue to the IMF from the quota increase. However, based on the official quota the U.S. voting share is only about 20 percent--clearly, taxation without equal representation. Indeed, the situation is worse than I have described, because by means of an SDR allocation the IMF can create and distribute new SDRs--thus printing the useable currency to cover the 25 percent requirement.

My testimony should not be misinterpreted as being anti-IMF, anti-big banks, or anti-Third World. But I am opposed to institutions and governments being stampeded by thoughtless fears along paths that might not be prudent. The foreign loans were made in the expectation that rising commodity prices, fueled by world inflation, would provide the export earnings to make them good. When the Federal Reserve deviated from the administration's monetary policy in 1981 and precipitated a recession, the expectations upon which the loans were based turned out to be wrong. Now banks, governments and the Federal Reserve itself are running for short-run cover without giving sufficient thought to the longer run implications of the bailout.

The deeper our banks, the State Department, the Treasury and the Federal Reserve get involved in trying to prop up old loans with new ones, the greater the stake they acquire in

the resurgence of world inflation. Rapidly rising oil and commodity prices would provide the Third World with growing revenues to service a depreciating debt--and the American consumer could be left holding the bag in a big way.

It wasn't that long ago that the United States stood astride the world like a colossus. Our financial and diplomatic power was respected, and countries sought to be in our good graces. We even managed to conduct our diplomacy through our own institutions. But today, after subordinating our interests to international organizations, the United States risks standing before the world as Uncle Sam. We ante up to quiet foreigners while the President's tax cuts and defense buildup fall under the budgetary knife.

The world has serious problems that require U.S. leadership, but the U.S. cannot lead as long as it acquiesces to demands. We must resist strongly the notion that foreign debtors have our banks over a barrel or they will take advantage of the situation to extract ever more American resources through the IMF.

Footnotes

- 1/ Alternatively, a system can be designed that sets aside loan loss reserves tied not to all loans but to those foreign loans that have not been repaid on time, with set-asides compulsory and rising in proportion to amounts rescheduled.

TABLE 1

Claims on Non-Oil Developing Countries:
Country Exposure Lending Survey Data for Nine Largest Banks
 (billions of dollars)

	Claims on Non-Oil De- veloping Countries	Reporting Banks' Total Assets	Reporting Banks' Total Capital	Claims on Non-Oil Developing Countries as a percent of:	
				Total Assets	Total Capital
1977 December	30.0	372.5	18.4	8.1	163
1978 June December	31.0	390.2	19.0	8.0	164
	33.4	422.5	20.0	7.9	176
79 June December	35.0	449.8	21.1	7.8	166
	39.9	486.1	21.9	8.2	182
1980 June December	41.9	508.4	23.0	8.2	182
	47.9	531.0	24.0	9.0	199
1981 June December	51.6	553.7	25.0	9.3	206
	57.6	564.6	26.1	10.2	220
1982 June	60.3	566.3	27.1	10.6	222

Source: Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, February 2, 1983.

TABLE 2

Claims on Selected Developing Countries
for Nine Large U.S. Banks

<u>Date</u>	<u>Claims (billions of dollars)</u>			<u>Total 3 Countries</u>
	<u>Argentina</u>	<u>Brazil</u>	<u>Mexico</u>	
1977	1.8	7.7	6.1	15.6
1978 June	1.9	8.0	5.9	15.8
December	1.8	8.5	6.1	16.4
1979 June	2.1	8.8	5.8	16.7
December	2.9	8.8	6.5	18.2
1980 June	3.3	9.1	7.3	19.7
December	4.2	9.4	9.1	22.7
1981 June	4.6	9.7	10.2	24.5
December	5.2	10.6	11.6	27.4
1982 June	5.3	11.8	13.4	30.5

<u>Date</u>	<u>Claims as Percent of Capital</u>			<u>Total 3 Countries</u>
	<u>Argentina</u>	<u>Brazil</u>	<u>Mexico</u>	
1977 December	9.8	41.8	33.2	84.8
1978 June	10.0	42.1	31.1	83.2
December	9.0	42.5	30.5	82.0
1979 June	10.0	41.7	27.5	79.1
December	13.2	40.2	29.7	83.1
1980 June	14.3	39.6	31.7	85.7
December	17.5	39.2	37.9	94.6
1981 June	18.4	38.8	40.8	98.0
December	19.9	40.6	44.4	105.0
1982 June	19.6	43.5	49.4	112.5

Source: Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, February 2, 1983.

ALTERNATIVES TO QUOTA INCREASE

Senator KASTEN. What is the alternative? You said there may be other alternatives which weren't fully considered and suggested that one of those alternatives would be to reduce rather than increase the level of debt.

Could you expand on that?

Mr. ROBERTS. Yes, I can. You can have a write-down of some percentage of those debts. By write-down I don't mean literally write-down of the loans, but you can have the same effect by the rescheduling, which stretches them out.

Senator KASTEN. Is write-down a variation of a writeoff? Is that what you are saying?

Mr. ROBERTS. I want to use the term in a broad, general way. You can achieve the effect of partial writeoff by rescheduling which stretches out the loan so that the annual service cost on the debtor nations would be reduced.

At the same time you can take measures, tax assisted or otherwise, that will allow the banks to build up their loan loss reserve.

Currently I think they are held to something like one percent by IRS regulations which, unless there has been a change recently, are about to be reduced to something like six-tenths of 1 percent. I think that this is a particularly shortsighted move given the situation.

If the banks had 3- to 5-percent reserve, we wouldn't have this crisis. So, you can take steps which protect the banks by building up their loan-loss reserve. You can take steps which reduce this debt burden by stretching out repayment which, of course, will affect the profitability of the loans to the banks, but it would also strengthen their position by reducing their exposure and by reducing the consequences of their exposure.

I think that this is something that should have been given more consideration.

CONDITIONALITY

Senator KASTEN. You commented on the so-called austerity requirements that the IMF imposes on countries. A number of people, particularly some of the Central American countries, I understand, feel that some of the austerity requirements or the economic requirements are really counterproductive in that they discourage free enterprise, they discourage private capital from coming into the country, and make it more difficult for individuals to receive an adequate return on their investments or, I should say, ideally would like an exceptional return on these investments in order to attract capital, in order to attract private enterprise.

Could you comment more on the requirements that the IMF is imposing on some of these countries, and do they, in fact, have a negative effect?

In other words, are they slowing down the economic growth of these developing countries?

Mr. ROBERTS. Mr. Chairman, IMF is a difficult situation because if they simply make the loans, no conditions, then they risk a situation where the countries could not even in principal ever pretend to pay the loan back.

As we know, IMF loans were supposed to be short term for temporary balance-of-payments problems and not some sort of long-term or permanent commitment to underwrite country deficits.

So, IMF's position, given its historic function, is that it cannot make permanent grants, so it has to impose some conditions.

Now, the logic behind this imposition of conditions is that if a country can restrain the growth of its imports and raise its exports, it would be able to accumulate hard exchange earnings to service the debt and get out of its crisis. Logically that makes sense.

But there are problems. One is if you have many countries in the same position and they are trading partners with one another, it is difficult for them to simultaneously increase their exports and reduce imports. In fact, it is impossible.

So, what tends to result from it is that the conditions are imposed all on the domestic economies or private sector primarily and consumption is reduced, business activity declines, there are layoffs.

There was a recent article in the Wall Street Journal on May 6 showing the situation in Brazil where a great deal of the upward mobility is being reversed, people are now moving back down the ladder because of the situation there. So, it is true that the IMF conditions can result in economic decline or troubles in the countries that are faced with it.

Yet, on the other hand, as I said, the IMF otherwise is in a position of granting aid. That has not been its historic function.

So that is one of the things that I was trying to point out, that we never before, I don't think, had an IMF quota increase for the purpose of bailing out banks and foreign governments on this sort of level, so once you do that, you have taken a definite step toward making IMF a sort of aid-giving agency because you have to ask how do you get out of this debt situation by piling debt on debt, by increasing banks' exposure when that is primarily the problem.

BANK BAILOUT

Senator KASTEN. You are assuming, aren't you, that they would never pay back the loans? In other words, nobody is getting bailed out right now. They are in, they are staying in, they are not getting out.

By saying it is a bailout, about which the Secretary of the Treasury yesterday was questioned by a couple of the members of the subcommittee, it would only be a bailout if in fact we were putting IMF dollars in and taking banking dollars out.

Are you suggesting that that is in fact what we are doing? That it will just take 10 or 15 more years to get to that point, or do you disagree with the basic idea that it is not a bailout?

Mr. ROBERTS. The terms are bail-in. It makes my point that the banks are already overexposed, so how are they being helped by getting additional exposure?

For the countries it is an additional debt burden. So, if the crisis is the result of the fact that the people already have excessive debt and excessive exposure, that is my point, you do not alleviate it by increasing both. I think it will ultimately be bailout, so let me point out something.

Apparently it is common knowledge that for Brazil we are talking about the second wave of funding for Brazil even before the Congress has passed its off-budget appropriation for this IMF quota increase which stands behind the first wave.

We are talking about the second wave of funding for Brazil. That is clear enough apparently already that what has been done for Brazil is not enough. Therefore, we are going to have to go further.

So now you can see the ultimate implications of this sort of pyramiding of debt is deflation, and the ultimate bailout would be a resurgence of world inflation which would generate rising commodity prices. Oil, for example, in order to increase the export earnings of the debtor nations to service these debts at the same time that the real value of the debt is devalued by inflation, is depreciated by the inflation.

So, my concern is the approach that the bail-in carries with it, we can say in the case of Brazil, already a second wave of funding. Ultimately the only way out, once everybody's prejudice is committed, would be resurgence of inflation. In that sense you see you have ultimate bailout.

BILATERAL VS. MULTILATERAL AID

Senator KASTEN. One of the major arguments that is made, and I am sure it is going to be made by the people who will appear after you, and as the Secretary of the Treasury pointed out, is how important the world monetary system is to us because we are so dependent on exports, and we need to continue to have a strong export program, we, therefore, need the necessary financing in order to provide jobs, et cetera.

It seems to me that we could get to that point with aid through things like IDA and IMF and ultimately lateral financial institutions, or we could get to that point through bilateral direct kinds of economic assistance country to country.

In some of the things you and former Secretary of the Treasury Bill Simon have written make the point that here we are in a multilateral financial institution in which we lose our leverage, we support countries whose basic principles are significantly different from ours, and we end up losing the kind of control and/or leverage that we would have with direct bilateral assistance.

I guess what you are suggesting, and so is the former Secretary of the Treasury Simon, is that if we have economic difficulties, why don't we take the \$8.4 billion and give it directly to the countries who are helping us, who are trading partners, rather than give to this multilateral worldwide financial institution?

Could you develop that basic point that we have problems, basic political problems, by contributing to a multinational economic institution?

Mr. ROBERTS. Yes; I think if you are going to give straight aid, that it is certainly a stronger argument for doing it in a bilateral way because you can extract quid pro quo which is much more difficult when you go through some international organization that you cannot control, and in addition if you give bilateral aid, you retain control over whom you give it to, when and in what amounts.

When it is given in some multilateral way or through some international organization, you are subject to being pressured by all the other participants, and you get the same kind of logrolling that you get here, up here on the Hill.

The outcome is not one that you can very effectively control. Therefore, you end up giving aid to cases which are not in our interests from an international standpoint. So, I think the case for bilateral as opposed to multilateral aid is very strong.

If, in fact, we are talking about aid, I think this comes back to one of my main points because the IMF is not supposed to be an aid-giving agency, that is not its charter. If it is turned into an aid-giving agency in some sense, its integrity is in trouble.

I would like to protect the agency, the International Monetary Fund, from being turned into an aid-giving agency, one that is in a position of permanently underwriting debtor nations' deficits.

U.S. EXPORTS

You raise another point. That is about the value to us from an export standpoint, that somehow this quota increase will be good for our exports. This is not a correct argument because whatever dollars we give out in this way, certainly some of them will come back, but all of those countries buy from other countries besides us, and you cannot expect that your exports will grow by the amount of the IMF quota increase unless you assume that the recipient countries spend all of the money that we subscribe to the quota back here, which, of course, they do not do.

I do not know what you get back, whether it is 10 cents on the dollar or 50 cents on the dollar, but certainly not an export program. It is a mistake to advocate it that way and obscures the real issues.

Of course, the international monetary system is important to us, it is important to all the countries of the world, and that is why I think that we have to be sure it doesn't become one whereby you simply have a mechanism in which the Third World extracts transfer payments from the developed world.

Once you have your international monetary mechanism take on that form, then what you really have is a de facto tax system and not an international monetary system.

Senator KASTEN. Mr. Roberts, thank you. I know you have a plane to catch. I appreciate your testimony.

There may be additional questions coming from other members of the subcommittee that we will submit to you in writing and hopefully you can get some answers back to us.

You have been helpful. We appreciate your testimony. Thank you very much.

Mr. ROBERTS. I am pleased to be here, Mr. Kasten.

Senator KASTEN. The next panel includes Mr. Clark who is the executive vice president of Citibank in New York; Mr. Moon, senior vice president of the National Bank of Detroit; and Mr. Pierce, treasurer of the Boeing Co., Seattle, Wash.

If all of you will come up at the same time, we will begin.

We don't have any special order. Just on an arbitrary basis. Mr. Pierce, why don't you start, then we will go to Mr. Moon and Mr.

Clark after which we will question all of you as a panel, the idea being that any of you can respond to any of the questions.

Mr. Jack Pierce from Seattle, Wash.

U.S. CHAMBER OF COMMERCE

STATEMENT OF JACK PIERCE, TREASURER, THE BOEING CO., ON BEHALF OF U.S. CHAMBER OF COMMERCE

ACCOMPANIED BY KATHRYN YOUNG, DIRECTOR OF INTERNATIONAL ECONOMIC POLICY, U.S. CHAMBER OF COMMERCE

U.S. EXPORT INTERESTS

Mr. PIERCE. Thank you.

I am testifying today on behalf of the Chamber of Commerce of the United States. With me is Kathryn Young, director of international economic policy at the U.S. Chamber of Commerce.

With your permission, we would like to submit our formal statement for the record.

Senator KASTEN. Your formal statement will be made a part of the record.

Mr. PIERCE. My remarks are directed primarily from the viewpoint of the U.S. export interests. In today's economic environment it is not difficult to explain why the U.S. export industries like Boeing, McDonnell-Douglas, Caterpillar, Westinghouse and many others and the thousands of suppliers and subcontractors across the United States, as well as thousands upon thousands of workers who depend on a world market business support the U.S. Chamber of Commerce, and we welcome the opportunity to testify in support of the IMF and to urge prompt congressional action to approve the administration's request for an increase in the IMF lending resources in the amount of \$8.4 billion.

We believe at this critical time the IMF must have sufficient resources to maintain a stable international financial system essential to political and economic security. Due to such urgency the IMF increase should be included in the fiscal year 1983 budget supplement, S. 695.

A strong connection exists between the IMF, world economic recovery, particularly in developing nations, and U.S. exports. The developing countries are our fastest growing markets accounting for approximately 40 percent of U.S. exports. It means jobs and economic growth in the United States.

There is a link, and a real link, between Malawi and Mozambique and Milwaukee; between Sudan and Seattle; Peru, Pittsburgh and Portland; Chile and Chicago; Brazil, Bolivia and Boston.

These customers match up with these U.S. cities where part of the 3,500 suppliers and subcontractors of Boeing are located, as well as the suppliers of other U.S. exporters, many of them small and individual exporters with an industrial export base, but directly linked to IMF facilities to do its job.

CONDITION OF INTERNATIONAL FINANCIAL SYSTEM

The international financial system is under severe strain. Developing nations face many problems in meeting their debt service re-

quirements, and the IMF plays a major role in this environment. The IMF is uniquely suited to do the job, provided its resources are adequate to meet the task.

IMF promotes a sound financial framework for the world economy, and it has already played a major role in moderating the severe financial strains which we are faced with today. But to continue to be effective, it will require a significant increase in its resources.

It is true that the U.S. contributions to IMF have economic cost. The U.S. Government must borrow to raise money when the IMF draws down the dollars. According to the U.S. Treasury, an estimated \$1 to \$1½ billion may be added to the Government borrowing needs per year for the quota increase.

However, recognizing such cost, the U.S. Chamber believes the U.S. contributions to IMF are a constructive use of taxpayers' dollars because they serve a variety of U.S. interests.

IMF provides resources to countries to implement sound economic adjustment programs, healthy markets overseas and opportunities for sales of U.S. goods and service which in turn provide jobs and investments in the United States.

Some critics claim that the IMF forces excessive austerity on borrowing countries. Some argue that by calling on such borrowing nations to develop trade promotion and to curtail imports the IMF takes jobs away from U.S. export industries. This may be true, but is on a short-term technical basis to get the developing nations on a sound footing.

• The Chamber believes these arguments are somewhat misleading. Essential imports, technically those which enhance the borrowing countries' productivity, are protected to the fullest extent possible. In fact, according to IMF, in 19 of 26 countries under IMF conditional adjustment programs the Fund estimates that real economic growth and imports are expected to be higher in the first program year than in the preceding 2 years.

SUCCESS OF IMF PROGRAMS

The IMF has proven it is an effective and respected institution and no other entity, domestic or international, can perform its function of encouraging sound economic adjustment while providing the necessary finance. All loans made by the IMF have been repaid, there has not been a default.

It is unfortunate that the IMF issue has become so singly identified with another issue of commercial bank lending practices. The IMF contribution benefits many of the developing nations, the international financial community, and the U.S. industrial base dependent on world market recovery and prosperity.

One real sound fact exists. Today there is a worldwide recession and this problem must be resolved. The IMF resources need to be increased.

Thank you very much.

[The prepared statement of Mr. Pierce follows:]

Statement of the Chamber of Commerce of the United States

on
THE INTERNATIONAL MONETARY FUND
by
Jack Pierce

The Chamber of Commerce of the United States is the largest federation of business and professional organizations in the world, and is the principal spokesman for the American business community. The U.S. Chamber represents more than 220,000 members, of which more than 216,000 are business firms, more than 2,600 are state and local chambers of commerce, and more than 1,200 are trade and professional associations.

More than 85 percent of the Chamber's members are small business firms having fewer than 100 employees. Yet, virtually all of the nation's largest industrial and business concerns are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the U.S. Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- numbers more than 15,000 members in the U.S. Chamber. Yet no one group constitutes as much as 23 percent of the total Chamber membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity and not a threat. In addition to the 47 American Chambers of Commerce Abroad, an increasing number of Chamber members are engaged in the export and import of both goods and services, and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

I am Jack Pierce, Treasurer, the Boeing Company. Today I am testifying on behalf of the Chamber of Commerce of the United States. Accompanying me is Kathryn Young, Director, International Economic Development Policy at the U.S. Chamber.

The U.S. Chamber welcomes the opportunity to testify in support of the International Monetary Fund (IMF) and to urge prompt Congressional action to approve the Administration's request for an increase in the IMF's lending resources in the amount of \$8.4 billion. The U.S. Chamber believes that at this critical time the IMF must have sufficient resources to carry out its responsibilities for maintaining a stable international financial system which is essential to the attainment of U.S. economic, political and security objectives. Due to the urgency of the matter the IMF increase should be included in the fiscal year 1983 budget supplemental, IMF S.695.

The United States must recognize the strong connection between the activities of the IMF, the economic recovery of the developing world and U.S. export performance. A fundamental ingredient of world economic recovery is consistent and sustained growth in world trade. A strong export performance by the United States is critical to that economic recovery. The developing countries are our fastest growing markets, accounting for approximately 40 percent of U.S. exports of goods and services, which translates into U.S. jobs and growth at home. Economic growth in the developing world is in our own self-interest. Expansion of third world markets, which will only come with financial stability and additional resources, offers valuable opportunities to improve our export performance in the future.

At this moment, for a variety of reasons, the international financial system is under severe strain because of the problems faced by a number of developing countries in meeting their debt service requirements. These problems must be managed effectively if the free world is to avoid large-scale economic disorders. The IMF was created, under U.S. leadership, to play a major role in dealing with these kinds of problems, and in many respects is uniquely suited to do so, provided that its resources are adequate to the task. It has always been anticipated that IMF resources would be increased as the world economy expanded, and the present proposals for an increase are in many ways part of that normal process -- albeit with a sense of urgency created by the current problems in the world economy. Thus, the request you are considering is most timely, and the U.S. Chamber supports immediate and favorable action. The strengthening of the IMF at this time is one of the most cost-effective ways in which the United States can ensure the stability of the system and the attainment of our own economic goals.

The Role of the IMF

The IMF was established to promote a sound financial framework for the

world economy. It does this in two ways. First, and most obvious, by providing necessary short-term financial assistance. Second, and perhaps even more important, by playing a leading role in formulating a program for borrowing countries designed to restore their long-term economic viability and creditworthiness. The "conditionality" attached to an IMF lending program, in turn, serves as a catalyst for attracting additional funding, both from official and private sources, to further the ultimate success of the program.

In fulfilling its responsibilities in this current period, the IMF has played a major role in seeking to moderate the severe financial problems that currently are straining the international financial system. In recent months several very large developing countries, including Mexico, Brazil, and Argentina, have experienced serious liquidity problems which have necessitated reschedulings as well as emergency infusions of new funds from commercial banks, governments and official institutions. Over twenty other countries are having difficulty in meeting current payments on outstanding loans. Faced with problems in meeting these obligations, many countries have turned to the IMF for assistance.

This unprecedented demand on international financial resources derives from the severity of the world recession in conjunction with weak commodity markets and a decline in world trade. The heavy borrowings in commercial markets, undertaken by many developing countries to sustain ambitious investment programs, have proved in some cases to be difficult to manage in the face of declining demand for their exports coupled with the high interest rate costs of servicing their debts.

If the IMF is to continue to be effective in assisting member countries to overcome their debt servicing and balance of payments problems, it will require a significant increase in resources this year.

The Impact of IMF Commitments on the U.S. Budget

U.S. participation in the IMF and the GAB requires Congressional authorizations and appropriations, but does not result in net budget outlays or increased budget deficits. These are standby and reciprocal commitments. The entire amount of the U.S. quotas consists of a "line of credit" to the IMF. Dollars flow from the United States to the IMF only when needed. As the line of credit is used, the IMF simultaneously increases the United States' reserve position in the IMF by the same amount -- thereby offsetting the dollar expenditure on the U.S. budget. Called a "monetary reserve asset," it is a fully liquid interest-earning asset which the United States can exchange, without penalties or conditions, for currency to use for balance of payments purposes.

It must be recognized that U.S. contributions to the IMF do have an economic cost. At the time that dollars are drawn upon by the IMF, the U.S. government must borrow to raise the monies, thus increasing the U.S. government's borrowing requirements and thereby adding pressure on the capital markets. However, the IMF turns to the government only when there is a net increase in its need for dollars, after taking into account repayments in U.S. dollars to the Fund made by debtor countries. Thus, the calls on the United States for dollars have normally come in small increments relative to the scale of the government's borrowing programs. According to the U.S. Department of the Treasury, an estimated \$1-\$1.5 billion may be added to the government's borrowing needs per year as a result of the quota increase. Treasury records show that as of December 31, 1982, the outstanding borrowing attributable to transactions with the IMF amounted to \$6.2 billion, about 1/2 of 1 percent of the total outstanding Treasury debt of \$1.2 trillion. Recognizing there is a cost involved in maintaining our commitments to the IMF and with due regard for limiting government expenditures, the U.S. Chamber feels that U.S. contributions to the IMF are a constructive use of taxpayers dollars because they serve a variety of U.S. interests.

The IMF and U.S. Interests

The IMF serves U.S. interests in several ways.

1) The IMF provides resources to countries in support of their efforts to implement sound economic adjustment programs. Healthy markets overseas mean opportunities for sales of U.S. goods and services. This, in turn, supports jobs and investment at home. This is an important consideration that is not always fully appreciated.

Weak economic performance in the developing countries has a direct impact on the United States. We have seen already an effect on U.S. trade with those developing countries facing major liquidity problems. Taking Mexico as an example, the value of U.S. exports to Mexico in 1982 fell 34 percent from the same period a year ago, declining from \$17.8 billion to \$11.8 billion. The \$6 billion drop in U.S. exports to Mexico is \$6 billion in lost business that is very real to the companies involved and to their workers whose jobs may have been affected. Even before the devaluation late last year, it was found that 38 percent of the materials vital to keeping Mexico's industrial plants functioning had to be purchased abroad. By early 1983, Mexico's industrial plants were working at only 40 percent of capacity and unemployment had reached 50 percent in nearly 300,000 factories due to the shortage of machinery, spare parts and raw materials -- plus a near total lack of dollars with which to buy them.

The United States has a strong and practical interest in helping our trading partners in times of economic difficulty to adjust and recover. To the extent the IMF is able to encourage these countries to take the necessary economic measures to restore their liquidity and creditworthiness, these countries will have a better chance to turn their economies around and revive demand for U.S. exports. Without IMF assistance in these difficulties their chances would be much dimmer and U.S. exports could fall even farther.

Some critics claim that IMF programs force excessive austerity measures on borrowing countries, slowing their growth and aggravating the global recession. It is also argued that, by calling for export promotion measures and urging countries to adopt policies that have the effect of curtailing their imports, IMF prescriptions take away jobs from U.S. export industries.

These arguments, the Chamber believes, are somewhat misleading. First of all, as a general observation, the objective of any IMF economic adjustment program is to help countries operate as close to normal as is possible and to avoid serious disruptions in trade and capital flows. Essential imports, particularly those that sustain or add to the country's productive capacity, are protected to the fullest extent possible. Secondly, and more important, the question is not whether imports may be reduced somewhat as the result of an IMF program; the question is how drastically imports would be reduced in the absence of an IMF program. Given the state of the economies of some of these countries, it seems clear that without an IMF program, their ability to import would be severely impaired, at best. If the objective is to try to maintain import levels as close to normal as is feasible, an IMF program is the best option available. In fact, according to the IMF, in 19 of 26 countries with IMF conditional adjustment programs, the Fund estimates that real economic growth and imports are expected to be higher in the first program year than in the preceding two years.

2) The United States, exercises strong leverage within the IMF. The United States as a major shareholder, holds 19 percent of the votes (controlling interest on major policy decisions is 15 percent). The United States has used this leverage to influence internal policies and to insist on corrective measures by debtor nations.

Not to be overlooked is the considerable leverage the IMF itself exerts. The IMF works to use its financial resources as only one ingredient in a total financing package for a given country. Other resources are sought, and usually successfully obtained, by the IMF from other governments and commercial lenders as well.

3) The IMF has proven itself to be a respected and effective instrumentality. No other agency, domestic or international, can perform its unique function of

encouraging sound economic adjustment while providing necessary financing. The IMF is not a development institution nor is it an aid agency -- it is a financial institution created to deal with short term liquidity problems by helping countries overcome temporary balance of payments problems and to assist borrowing countries restore their long term economic viability and creditworthiness. All loans made by the IMF have been repaid; there has never been a default.

Role of Commercial Banks

I would like to address briefly a common misconception that supporting the IMF is nothing more than a "bailout for commercial banks." Far from bailing out the banks, the IMF has taken on the role of seeking to ensure that commercial banks retain their commitments. In recent cases, the IMF, as a condition to proceeding with its own programs, has insisted that commercial bank lenders not only stay with their outstanding loans, but even increase them. Under present economic conditions, countries in balance of payments difficulties need to buy time to allow their adjustment programs to work. In many cases, the IMF has been instrumental in fitting together the pieces of a financing package sufficient to avoid default and to enable the country involved to work out an adjustment program. The result has been to minimize damage to the international credit system and allow the debtor countries to negotiate realistic payments schedules with their private and official creditors, while reordering their domestic economies to reduce future needs for external borrowing.

The commercial banks are very much involved in this process, and their continued involvement is essential to the success of the IMF's economic stabilization programs and to the developing countries. These countries will continue to need additional financing in the years to come and private bank lending is being counted on to provide part of that financing. The current hesitancy of regional and smaller U.S. banks to maintain their commitments to Brazil, thus endangering the entire IMF coordinated financial resource package for that country, underscores the critical need to ensure that commercial banks remain active players.

It is unfortunate that the IMF issue in Congress has become so identified with criticizing the lending practices of commercial banks, and has become in fact, in the minds of many, simply another banking bill. This overemphasis on the role of banks in the international debt situation has meant that the IMF's contributions in benefiting the developing countries, the international financial community and the United States through employment and balance of payments benefits has not been sufficiently appreciated.

In the Senate, these banking concerns should have been sufficiently

addressed in S.695, as reported out of the Senate Banking Committee. Provisions in the bill strengthen the role of federal regulators and tighten up on bank lending and reporting practices, without apparently unduly penalizing the banks. S.695 appears to be a constructive compromise which should now enable the Senate to consider expeditiously the IMF increase request.

Conclusion

It is unfortunate that this question of an increase in the IMF's resources, requiring an additional financial commitment by the United States, should come at this time of constraint in our own economy. However, circumstances -- mainly the current world-wide recession -- have led us to this point, and there is a problem that must be resolved. It must be resolved because it has a direct impact on the U.S. economy, as well as the more general U.S. interest in maintaining a stable international economic system. The IMF is well designed to cope with problems of this kind, and offers one of the most cost-effective ways for the United States to achieve our own national objectives. We do not have many options available; to do nothing in these circumstances would have serious adverse consequences for the free world economic system, our general political and security goals, and, in a very direct way on the United States' economy itself. Our own economy cannot afford the risk of a major threat to the stability of the international financial system, or of a breakdown in international trade and capital flows.

Clearly, the IMF's resources need to be increased, however, we would caution not at the expense of U.S. exporters. If Congress moves to place additional onerous restrictions on banks which could result not only in reduced bank participation in traditional lending to developing countries but which could also affect the willingness of banks to finance trade and project financing, the outcome would be counterproductive to our efforts to expand U.S. exports.

BANKERS' ASSOCIATION FOR FOREIGN TRADE

STATEMENT OF PHILIP G. MOON, SENIOR VICE PRESIDENT, NATIONAL BANK OF DETROIT, ON BEHALF OF THE BANKERS' ASSOCIATION FOR FOREIGN TRADE

ACTIVITIES OF BAFT

Senator KASTEN. Mr. Moon.

Mr. MOON. Mr. Chairman and members of the subcommittee, my name is Philip G. Moon, and I am president of the Bankers' Association for Foreign Trade [BAFT]. I am also senior vice president of the National Bank of Detroit.

Since its founding in 1921, BAFT has sought to develop sound banking procedures and services in support of trade. Beginning in the mid-1970's, BAFT made a major commitment to international banking education and to legislative and regulatory activities in the international banking area.

Today, BAFT's voting membership of 154 U.S. banks includes virtually all of those having significant international operations.

BAFT strongly supports U.S. participation in the proposed expansion of the International Monetary Fund resources that is before this subcommittee. Without a timely and adequate increase in IMF resources, the ability of the international financial system to weather debt and liquidity problems will be impaired, at substantial direct and indirect cost to the United States.

The U.S. stake in the international trading system—to understand the importance of the IMF to the United States, one first has to understand the U.S. growing stake in international trade. Exports as a percent of GNP have almost doubled since 1970, increasing from 6.6 percent to 11.4 percent in 1982.

More than 10 percent of all jobs in the United States rely on goods produced for export. For agriculture, the percentage is even higher, with almost 24 percent of all agricultural jobs dependent upon exports.

NEW U.S. JOBS A RESULT OF INCREASED EXPORTS

Perhaps most significantly, it has been estimated that 80 percent of all new jobs created in the United States from 1977 through 1980 stemmed from the dramatic increase in exports during that period.

Our growing stake in international trade has, of course, resulted in a growing interdependence between the United States and world economy. In recent years, this interdependence has become particularly striking with respect to the developing nations.

The 20 largest U.S. trading partners, in terms of total merchandise transactions, include 11 developing nations. More than 40 percent of U.S. exports and 1 manufacturing job in 20 hinge on sales to developing nations. The United States now sells more manufactured goods to developing nations than it does to Europe and Japan combined.

FINANCING OF WORLD TRADE

During this period of rapid growth in world trade, and of U.S. participation in it, U.S. banks quite naturally increased their international activities to meet the needs of their customers. As developing nations became the fastest growing markets for U.S. exports, U.S. banks' financing of their customers' trade with these countries naturally increased.

For instance, National Bank of Detroit is heavily involved in the automotive industry, and that is reflected in the places we do business overseas. As an example, one type of loan that is characteristic of our Mexican portfolio is financing for purchases of locomotives by the Mexican Government—locomotives manufactured by General Motors Corp., an important bank customer.

While the image of the go-go banker is a popular one in the media these days, we respectfully suggest that most of our members have become involved in loans to developing countries to support the rather straightforward type of U.S. export trade transaction which I just described.

Robert Heller, international economist for Bank of America, has quantified this relationship between foreign lending and the growth of U.S. exports by showing that there is a correlation coefficient of 0.91 between the growth of U.S.-bank foreign assets and the growth of U.S. exports over the years 1963-82.

ORIGINS OF THE CURRENT DEBT PROBLEM

The twin oil shocks of the 1970's put added pressure on the international banking system to recycle OPEC surpluses and to meet increased demands for financing from developing nations. To a large extent, bank lending to developing countries provided the engine needed to pull the world economy out of the recession resulting from the first oil shock in 1973.

Even when world trade collapsed during the 1974-75 recession, the demand of developing nations for exports of food and capital goods from the industrial nations continued to rise, helping to cushion the effects of the economic downturn on our own industries and our own farmers.

For example, U.S. exports to the developing nations during this period increased at an annual rate of about 30 percent, nearly twice as fast as the growth of U.S. exports to industrial countries.

The 1979 oil shock again resulted in an upsurge of demand from the developing nations. However, since the economic downturn of 1979, the world economy has fallen into virtual stagnation. Since 1979, world trade has also come to a halt—and has even contracted in the 1981-82 period.

Demand for commodities and raw materials slumped, and therefore prices fell. Exports of many developing nations fell automatically, and their efforts to diversify into exports of manufactures ran up against recession and protectionist pressures in the industrialized world.

In addition, the relationship between interest rates and inflation changed sharply in the early 1980's after the monetary authorities in most industrialized countries adopted stringent anti-inflationary policies. While these policies were highly successful in lowering the

inflation rate, they also resulted in temporary upward pressures on interest rates.

In particular, real interest rates increased sharply, rising to more than 9 percent in 1981. Because real interest rates greatly exceeded economic growth rates for many borrowing countries during 1981-82, the financial equation upon which the debt financing was based was temporarily upset.

Worldwide recession, stagnant world trade, depressed commodity prices, and high real interest rates have thus pushed many developing nation borrowers into a classic liquidity squeeze. Export earnings are not sufficient to meet debt service burdens without significant adjustments in their economic policies and reschedulings of their existing debt. It is at this point where the role of the IMF is so critical.

ROLE OF THE IMF

The IMF maintains a revolving fund of currencies that any of its members may draw when they need temporary help for balance-of-payments purposes. A large part of this financing is extended in support of economic and financial programs under which governments adopt comprehensive policy changes designed to restore the country's external payments to a sustainable basis within a medium-term framework.

It is this latter ability to attach effective conditions to its lending that makes the IMF unique among international financial intermediaries and that also makes it indispensable to maintaining private bank lending to many developing nations.

IMF conditions are meant to insure that its funds will be repaid on time, and that the balance-of-payments adjustments of members making use of them will proceed in a smooth and orderly way; that is, without resort to restrictions on their trade and payments and other measures that are disruptive to international economic relations.

IMF financing permits countries to sustain needed imports while they adjust, thereby ameliorating domestic social conditions during the adjustment period. This is a key point often lost in the media, which at times has highlighted negative political reactions to IMF conditionality in borrowing countries.

Without an orderly IMF program, economic adjustments would be more severe and social unrest even greater.

Consistent with its basic purposes, the IMF has played the leading role in managing the recent liquidity crises involving developing nations, but its resources could be dangerously stretched in the period ahead. IMF resources have shrunk dramatically over the last two decades, falling from over 12 percent of world trade in 1960 to under 4 percent today.

The IMF needs the proposed increases before this subcommittee if it is to continue to assist countries in meeting short-term liquidity crises and in supporting adjustment programs that are flexible enough to be economically effective, as well as politically and socially sustainable.

We thus strongly support the proposed increase in IMF resources before this subcommittee.

While the IMF needs more resources to do the job it was designed to do, it cannot do the job alone. Other government, international institution, and private credit support must continue to flow to the developing nations to enable them to service their debt and remain part of the world trading system.

We would, in particular, like to focus on the need for private bank credit flows and, in the process, address some of the criticisms that have been made of private bank lending to LDC's.

IMF BAILS BANKS "IN" NOT "OUT"

Significant financing will be required for developing nations in the years ahead. Under an economic scenario developed by the Morgan Guaranty Trust Co., which scenario assumes moderate economic recovery in the OECD nations, 21 major developing countries will need approximately \$70 billion in new lending through 1985 from private banks (both United States and non-United States).

While this is a large amount, it should be pointed out that it assumes a growth rate in private bank lending to major developing nations of only 7 percent per year. This compares with growth rates exceeding 20 percent in the early 1980's.

Private credit will not flow in these quantities unless the IMF is involved, because, as noted earlier, it is the only international institution with the clout to impose conditions which insure that balance-of-payments adjustments will be made. By the same token, the IMF's resources are far too small to meet developing nation's total credit needs and will remain so even after they are enlarged.

For that reason, the IMF has been "bailing in" the banks, not bailing them out.

Over the last year, the IMF has insisted that commercial bank creditors commit new financing before the IMF will commit its own. Under present economic conditions, the need of countries in balance-of-payments difficulty is for financing to buy time to allow adjustment programs to work.

The IMF's objective has been to assemble that "critical mass" of financing that would stave off default while insuring that other creditors close the much larger gap in a country's financial needs. Thus, a modest IMF component has been leveraged to a multiple of its size by requiring private bank financing to close the necessary gaps.

The IMF is not throwing good money after bad—as recently noted by William R. Cline, senior fellow of the Institute for International Economics. There is a minority view which contends that to provide more lending by the IMF or private banks to developing countries would be to throw good money after bad, and that it would be best to cut losses now. We strongly reject that view, and urge the Congress to do so as well.

It is first of all important to note that the private banking community by and large has limited its lending to countries that are industrialized, are well underway toward industrialization, or have necessary resources and a demonstrated capability for generating and sustaining long-term economic growth.

These countries—like all countries—are suffering from the effects of global recession and high real interest rates. But the underlying strengths that provided the basis for large-scale international lending in the past are still there. The potential in resources, human and physical, remains. The real policy challenge is to get the global economy moving again.

BANK LOANS TO DEVELOPING NATIONS

With respect to bank loans to developing nations, it must also be pointed out that these loans have been funded largely out of foreign deposits. In particular, the ten largest U.S. banks are net users of foreign funds, as they have more outstanding liabilities to foreigners than they hold in foreign assets.

Rather than taking funds out of the United States to support foreign loans, U.S. banks provide an important service as financial intermediaries that generate jobs and income for many Americans.

The dangers presented by proposals that would, in effect, cut off developing nations from further credit were again described by Mr. Cline of the Institute for International Economics:

Large write-downs and cessation of lending [to developing nations] would be precisely the wrong things to do: They would essentially force the country unnecessarily into insolvency. These measures would turn good debt into bad debt.

Moreover, an abrupt contraction of international credit at this time, to the point that LDCs are unable to refinance their debt, would have ramifications beyond the accumulation of large amounts of nonperforming LDC loans on the books of the world's banks, small as well as large.

It would force banks to limit credit and to raise interest rates to domestic as well as foreign customers to compensate for the adverse effects of loan losses, and to cover growing risks in lending to other domestic and foreign borrowers who might be hurt by an overall contraction in credit and world trade.

An abrupt contraction in international credit would also cause a contraction in world demand, aborting any possibility for world recovery, and risking an even deeper downturn at home as well as abroad.

Legislation to restrict international lending—while the dangers of this more extreme minority view are obvious, there are less obvious, but no less significant dangers in the view that IMF approval must be tied to highly restrictive controls on U.S. bank lending abroad.

The dangers in this view have been stressed not only by private banks but also by Secretary Regan, Chairman Volcker and by the Federal banking agencies, and were, perhaps, most succinctly put by Comptroller of the Currency Todd Conover:

In dealing with this [debt] problem we must strike a balance between long- and short-term considerations. Over the long term, we must achieve greater discipline in international lending. But, in doing so, we must make certain that our actions do not precipitate the very crisis we are seeking to avoid.

We cannot cut off international credit flows, or we will restrict international trade, compound the economic problems now facing borrower countries, and contribute to social and political unrest. Therefore, our actions must not result in an immediate reduction in international lending. Instead, for the short term, the risk inherent in the existing exposure must be reduced—that is, the borrowing countries must be restored to economic health.

INTERNATIONAL LENDING REFORMS

With some regard for the regulatory balance that needs to be struck, the bank regulatory agencies have proposed a five-point program of international lending "reforms" aimed at the following:

First. Strengthened country risk examination and supervision;

Second. Additional reporting and disclosure of country risks;

Third. Prudential reserves for problem loans with protracted repayment difficulties;

Fourth. Changes in accounting for fee income; and

Fifth. Stronger cooperation with foreign bank supervisors and the IMF.

The Senate Banking Committee recently amended the IMF authorization bill to include legislation establishing these five reforms, along with a committee provision directing the banking agencies to require banking institutions to maintain adequate levels of capital.

While the BAFT membership has a number of concerns with the regulators' proposals and the Senate Banking Committee bill, we believe the regulators and Senate Banking Committee have sincerely sought to achieve a balance between long-term regulatory objectives and short-term considerations of maintaining adequate private credit flows to the developing nations.

The Senate Banking Committee bill is a tough proposal and it may have very real and possibly severe impacts on international lending. The bill does, however, provide the bank regulators with some flexibility, and flexibility is desperately needed in light of the many reschedulings we face in the next several years.

Overregulation could drive many regional and smaller banks out of international lending precisely at the time they are needed to maintain international liquidity. Thus, the reforms proposed in the Senate Banking Committee bill, if enacted, will have to be administered in a prudent manner to insure that they do not lead to the crisis which we are all trying to avoid.

In light of our concerns, we would strongly oppose any attempts to go beyond what is already included in the Senate Banking Committee bill. Debt rescheduling is a fragile process, and cooperation is required from a great number of banks, large and small.

The more restrictions and penalties imposed on new bank lending, the more difficult it will be to make this process work. And if this process does not work, management of current debt problems, even with an increase in IMF resources, could become overwhelming.

RELATION OF IMF FUNDING TO DOMESTIC JOBS AND CREDIT MARKETS

The argument is sometimes made that IMF adjustment programs cost U.S. jobs since, in the short term, they can result in reduced imports in order to restore financial health.

While it is true IMF adjustment programs often include short-term reductions in Government spending, in budget deficits, and in public sector and foreign borrowing, their purpose is to help countries return to functioning in international trade as soon as possible.

When an IMF program is successful, the outcome is the restoration of balanced growth that quickly sees imports rising as the

country's productive capacity, and hence its capacity to pay for imports, increases. Long-term IMF programs are U.S. job-creating programs.

The benefits of orderly adjustment are demonstrated by Turkey. Turkey agreed with the IMF on a series of stabilization measures in 1978-80 when it suffered severe international payments problems. Since 1979 the dollar value of imports by Turkey has doubled.

In contrast, without orderly IMF adjustment, countries are often forced to cut imports drastically. For example, the onset of the debt crisis caused U.S. exports to Mexico to plummet by 50 percent in the second half of 1982. Simply put, the alternative to IMF adjustment programs is a return to the types of trade and exchange policies which led to the great depression of the 1930s.

Finally, arguments are sometimes advanced that U.S. dollars approved by the Congress for IMF purposes will add materially to U.S. Government borrowing requirements, thus further crowding out private borrowers in the credit markets.

IMF DOLLARS TAKEN FROM DOMESTIC PROGRAMS

A somewhat related objection is that dollars allocated to the IMF are dollars taken from domestic programs. In our judgment, these arguments reflect a basic misunderstanding of U.S. involvement in IMF resource increases.

The U.S. dollars approved by Congress for IMF purposes do not constitute spending in the usual sense, nor do they add to the budget deficit.

First, no money is actually paid to the IMF when the quota increase becomes effective. Instead, a noninterest bearing, nonnegotiable Treasury note, payable on demand, is submitted to the IMF.

Second, if the IMF draws on the note, it will credit the U.S. accounts with the IMF at the same moment. That is, the net asset position of the U.S. Treasury is unchanged. The U.S. Government budget deficit is not affected as the U.S. Treasury gains an asset—the IMF reserve position—at the same time that it incurs a liability to the financial markets. From that moment on, the Treasury will have to pay interest on its outstanding obligations, but it will also earn interest on its IMF balances.

Third, as economist Robert Heller of the Bank of America has described it, the net impact on U.S. credit markets depends on the way in which the country that borrows the funds from the IMF utilizes these funds. If the country uses the proceeds to acquire financial assets denominated in U.S. dollars or reduces its liabilities to U.S. institutions, there will be no net effect on U.S. credit markets.

If, however, the foreign country spends the IMF borrowings directly or indirectly on U.S. goods and services, there will be a net effect on credit markets, as the borrowing will not be counterbalanced by an inflow into U.S. credit markets. Credit markets will experience a net demand for funds, but at the same time U.S. exports will increase, providing a direct benefit to the United States.

In sum, over the short term, IMF funding should have no effect on the U.S. budget deficit as the Treasury only posts a promissory

note. Over the long term, IMF funding increases dollar spending by foreign countries, thereby supporting our own economic recovery.

CONCLUSION

For the reasons we have discussed in our statement today, we strongly support U.S. participation in increased funding for the IMF. The domestic and international financial markets are closely following U.S. action on IMF funding, and U.S. leadership and action on this issue will contribute greatly to market confidence in a continued and strengthened domestic and international economic recovery.

Thank you, Mr. Chairman.

Senator KASTEN. Thank you very much.

[The prepared statement and accompanying charts of Mr. Moon follow:]

PREPARED STATEMENT OF PHILIP G. MOON

PRESIDENT

BANKERS' ASSOCIATION FOR FOREIGN TRADE

AND

SENIOR VICE PRESIDENT

NATIONAL BANK OF DETROIT

Mr. Chairman and Members of the Subcommittee:

My name is Philip G. Moon and I am President of the Bankers' Association for Foreign Trade (BAFT). I am also Senior Vice President of the National Bank of Detroit.

Since its founding in 1921, BAFT has sought to develop sound banking procedures and services in support of trade. Beginning in the mid 1970s, BAFT made a major commitment to international banking education and to legislative and regulatory activities in the international banking area. Today, BAFT's voting membership of 154 U.S. banks includes virtually all of those having significant international operations.

BAFT strongly supports United States participation in the proposed expansion of International Monetary Fund (IMF) resources that is before this Subcommittee. Without a timely and adequate increase in IMF resources, the ability of the international financial system to weather debt and liquidity problems will be impaired, at substantial direct and indirect cost to the United States.

THE U.S.'S STAKE IN THE
INTERNATIONAL TRADING SYSTEM

To understand the importance of the IMF to the U.S., one first has to understand the U.S.'s growing stake

in international trade. Exports as a percent of GNP have almost doubled since 1970 increasing from 6.6 percent to 11.4 percent in 1982. More than 10 percent of all jobs in the United States rely on goods produced for export. For agriculture, the percentage is even higher, with almost 24 percent of all agricultural jobs dependent upon exports. Perhaps, most significantly, it has been estimated that 80 percent of all new jobs created in the United States from 1977 through 1980 stemmed from the dramatic increase in exports during that period.

Our growing stake in international trade has, of course, resulted in a growing interdependence between the U.S. and world economy. In recent years, this interdependence has become particularly striking with respect to the developing nations. The twenty largest U.S. trading partners, in terms of total merchandise transactions, include eleven developing nations. More than 40 percent of U.S. exports and one manufacturing job in 20 hinge on sales to developing nations. The U.S. now sells more manufactured goods to developing nations than it does to Europe and Japan combined.

FINANCING OF WORLD TRADE

During this period of rapid growth in world trade, and of U.S. participation in it, U.S. banks quite naturally increased their international activities to meet the needs of their customers. As developing nations became the fastest growing markets for U.S. exports, U.S. banks financing of their customers' trade with these countries naturally increased. For instance, National Bank of Detroit is heavily involved in the automotive industry, and that is reflected in the places we do business overseas. As an

example, one type of loan that is characteristic of our Mexican portfolio is financing for purchases of locomotives by the Mexican government -- locomotives manufactured by General Motors Corp., an important bank customer. While the image of the go-go banker is a popular one in the media these days, we respectfully suggest that most of our members have become involved in loans to developing countries to support the rather straightforward type of U.S. export trade transaction which I just described. Robert Heller, international economist for Bank of America, has quantified this relationship between foreign lending and the growth of U.S. exports by showing that there is a correlation coefficient of .91 between the growth of U.S. bank foreign assets and the growth of U.S. exports over the years 1963-1982.

ORIGINS OF THE CURRENT DEBT PROBLEM

The twin oil shocks of the 1970s put added pressure on the international banking system to recycle OPEC surpluses and to meet increased demands for financing from developing nations. To a large extent, bank lending to developing countries provided the engine needed to pull the world economy out of the recession resulting from the first oil shock in 1973. Even when world trade collapsed during the 1974-75 recession, the demand of developing nations for exports of food and capital goods from the industrial nations continued to rise, helping to cushion the effects of the economic downturn on our own industries and our own farmers. For example, U.S. exports to the developing nations during this period increased at an annual rate of about 30%, nearly twice as fast as the growth of U.S. exports to industrial countries.

The 1979 oil shock again resulted in an upsurge of demand from the developing nation.. However, since the economic downturn of 1979, the world economy has fallen into virtual stagnation. Since 1979, world trade has also come to a halt -- and has even contracted in the 1981-1982 period. Demand for commodities and raw materials slumped, and therefore prices fell. Exports of many developing nations fell automatically, and their efforts to diversify into exports of manufactures ran up against recession and protectionist pressures in the industrialized world.

In addition, the relationship between interest rates and inflation changed sharply in the early 1980s after the monetary authorities in most industrialized countries adopted stringent anti-inflationary policies. While these policies were highly successful in lowering the inflation rate, they also resulted in temporary upward pressures on interest rates. In particular, real interest rates increased sharply, rising to more than 9 percent in 1981. Because real interest rates greatly exceeded economic growth rates for many borrowing countries during 1981-82, the financial equation upon which the debt financing was based was temporarily upset.

Worldwide recession, stagnant world trade, depressed commodity prices and high real interest rates have thus pushed many developing nation borrowers into a classic liquidity squeeze. Export earnings are not sufficient to meet debt service burdens without significant adjustments in their economic policies and reschedulings of their existing debt. It is at this point where the role of the IMF is so critical.

THE ROLE OF THE IMF

The IMF maintains a revolving fund of currencies that any of its members may draw when they need temporary help for balance of payments purposes. A large part of this financing is extended in support of economic and financial programs under which governments adopt comprehensive policy changes designed to restore the country's external payments to a sustainable basis within a medium-term framework.

It is this latter ability to attach effective conditions to its lending that makes the IMF unique among international financial intermediaries and that also makes it indispensable to maintaining private bank lending to many developing nations. IMF conditions are meant to ensure that its funds will be repaid on time, and that the balance of payments adjustments of members making use of them will proceed in a smooth and orderly way, i.e. without resort to restrictions on their trade and payments and other measures that are disruptive to international economic relations. IMF financing permits countries to sustain needed imports while they adjust, thereby ameliorating domestic social conditions during the adjustment period. This is a key point often lost in the media, which at times has highlighted negative political reactions to IMF conditionality in borrowing countries. Without an orderly IMF program, economic adjustments would be more severe and social unrest even greater.

Consistent with its basic purposes, the IMF has played the leading role in managing the recent liquidity crises involving developing nations, but its resources could be dangerously stretched in the period ahead. IMF resources

have shrunk drastically over the last two decades, falling from over 12 percent of world trade in 1960 to under 4 percent today. The IMF needs the proposed increases before this Subcommittee if it is to continue to assist countries in meeting short-term liquidity crises and in supporting adjustment programs that are flexible enough to be economically effective as well as politically and socially sustainable. We thus strongly support the proposed increase in IMF resources before this Subcommittee.

While the IMF needs more resources to do the job it was designed to do, it cannot do the job alone. Other government, international institution and private credit support must continue to flow to the developing nations to enable them to service their debt and remain part of the world trading system. We would, in particular, like to focus on the need for private bank credit flows and, in the process, address some of the criticisms that have been made of private bank lending to LDCs.

THE IMF BAILS BANKS "IN" NOT "OUT"

Significant financing will be required for developing nations in the years ahead. Under an economic scenario developed by the Morgan Guaranty Trust Company, which scenario assumes moderate economic recovery in the OECD nations, 21 major developing countries will need approximately \$70 billion in new lending through 1985 from private banks (both U.S. and non-U.S.). While this is a large amount, it should be pointed out that it assumes a growth rate in private bank lending to major developing nations of ^{only} 7 percent per year. This compares with growth rates exceeding 20 percent in the early 1980s. Private credit will not flow in these quantities unless the IMF is involved, because, as noted earlier,

it is the only international institution with the clout to impose conditions which ensure that balance of payments adjustments will be made. By the same token, the IMF's resources are far too small to meet developing nations' total credit needs and will remain so even after they are enlarged. For that reason, the IMF has been "bailing in" the banks, not bailing them out.

Over the last year, the IMF has insisted that commercial bank creditors commit new financing before the IMF will commit its own. Under present economic conditions, the need of countries in balance of payments difficulty is for financing to buy time to allow adjustment programs to work. The IMF's objective has been to assemble that "critical mass" of financing that would stave off default while insuring that other creditors close the much larger gap in a country's financial needs. Thus, a modest IMF component has been leveraged to a multiple of its size by requiring private bank financing to close the necessary gaps.

THE IMF IS NOT THROWING GOOD MONEY AFTER BAD

As recently noted by William R. Cline, Senior Fellow of the Institute for International Economics, there is a minority view which contends that to provide more lending by the IMF or private banks to developing countries would be to throw good money after bad, and that it would be best to cut losses now. We strongly reject that view and urge the Congress to do so as well.

It is first of all important to note that the private banking community by and large has limited its lending to countries that are industrialized, are well underway towards industrialization, or have necessary

resources and a demonstrated capability for generating and sustaining long-term economic growth. These countries -- like all countries -- are suffering from the effects of global recession and high real interest rates. But the underlying strengths that provided the basis for large-scale international lending in the past are still there. The potential in resources, human and physical, remains. The real policy challenge is to get the global economy moving again.

With respect to bank loans to developing nations, it must also be pointed out that these loans have been funded largely out of foreign deposits. In particular, the ten largest U.S. banks are net users of foreign funds, as they have more outstanding liabilities to foreigners than they hold in foreign assets. Rather than taking funds out of the U.S. to support foreign loans, U.S. banks provide an important service as financial intermediaries that generate jobs and income for many Americans.

The dangers presented by proposals that would, in effect, cut off developing nations from further credit were again described by Mr. Cline of the Institute for International Economics:

"[l]arge write-downs and cessation of lending [to developing nations] would be precisely the wrong things to do: they would essentially force the country unnecessarily into insolvency. These measures would turn good debt into bad debt."

Moreover, an abrupt contraction of international credit at this time, to the point that LDCs are unable to refinance their debt, would have ramifications beyond the accumulation of large amounts of non-performing LDC loans on the books of the world's banks, small as well as large. It

would force banks to limit credit and to raise interest rates to domestic as well as foreign customers to compensate for the adverse effects of loan losses, and to cover growing risks in lending to other domestic and foreign borrowers who might be hurt by an overall contraction in credit and world trade. An abrupt contraction in international credit would also cause a contraction in world demand, aborting any possibility for world recovery, and risking an even deeper downturn at home as well as abroad.

LEGISLATION TO RESTRICT INTERNATIONAL LENDING

While the dangers of this more extreme minority view are obvious, there are less obvious but no less significant dangers in the view that IMF approval must be tied to highly restrictive controls on U.S. bank lending abroad.

The dangers in this view have been stressed not only by private banks but also by Secretary Regan, Chairman Volcker and by the federal banking agencies, and were, perhaps, most succinctly put by Comptroller of the Currency Todd Conover:

"In dealing with this [debt] problem we must strike a balance between long- and short-term considerations. Over the long term, we must achieve greater discipline in international lending. But, in doing so, we must make certain that our actions do not precipitate the very crisis we are seeking to avoid. We cannot cut off international credit flows, or we will restrict international trade, compound the economic problems now facing borrower countries, and contribute to social and political unrest. Therefore, our actions must not result in an immediate reduction in international lending. Instead, for the short term, the risk inherent in the existing exposure must be reduced -- that is, the borrowing countries must be restored to economic health."

With some regard for the regulatory balance that needs to be struck, the bank regulatory agencies have pro-

posed a 5-point program of international lending "reforms" aimed at the following: (1) strengthened country risk examination and supervision; (2) additional reporting and disclosure of country risks; (3) prudential reserves for problem loans with protracted repayment difficulties; (4) changes in accounting for fee income; and (5) stronger cooperation with foreign bank supervisors and the IMF. The Senate Banking Committee recently amended the IMF authorization bill to include legislation establishing these five reforms, along with a Committee provision directing the banking agencies to require banking institutions to maintain adequate levels of capital.

While the BAFT membership has a number of concerns with the regulators' proposals and the Senate Banking Committee bill, we believe the regulators and Senate Banking Committee have sincerely sought to achieve a balance between long-term regulatory objectives and short-term considerations of maintaining adequate private credit flows to the developing nations. The Senate Banking Committee bill is a tough proposal and it may have very real and possibly severe impacts on international lending. The bill does, however, provide the bank regulators with some flexibility, and flexibility is desperately needed in light of the many reschedulings we face in the next several years. Overregulation could drive many regional and smaller banks out of international lending precisely at the time they are needed to maintain international liquidity. Thus, the reforms proposed in the Senate Banking Committee bill, if enacted, will have to be administered in a prudent manner to ensure that they do not lead to the crises which we are all trying to avoid.

In light of our concerns, we would strongly oppose

any attempts to go beyond what is already included in the Senate Banking Committee bill. Debt rescheduling is a fragile process, and cooperation is required from a great number of banks, large and small. The more restrictions and penalties imposed on new bank lending, the more difficult it will be to make this process work. And if this process does not work, management of current debt problems, even with an increase in IMF resources, could become overwhelming.

RELATION OF IMF FUNDING TO DOMESTIC
JOBS AND CREDIT MARKETS

The argument is sometimes made that IMF adjustment programs cost U.S. jobs since, in the short-term, they can result in reduced imports in order to restore financial health. While it is true IMF adjustment programs often include short-term reductions in government spending, in budget deficits, and in public sector and foreign borrowing, their purpose is to help countries return to functioning in international trade as soon as possible. When an IMF program is successful, the outcome is the restoration of balanced growth that quickly sees imports rising as the country's productive capacity, and hence its capacity to pay for imports, increases. Long-term IMF programs are U.S. job-creating programs.

The benefits of orderly adjustment are demonstrated by Turkey. Turkey agreed with the IMF on a series of stabilization measures in 1978-80 when it suffered severe international payments problems. Since 1979 the dollar value of imports by Turkey has doubled. In contrast, without orderly IMF adjustment, countries are often forced to cut imports drastically. For example, the onset of the debt crisis caused U.S. exports to Mexico to plummet by 50 percent in the second half of 1982. Simply put, the alternative to IMF

adjustment programs is a return to the types of trade and exchange policies which led to the great depression of the 1930s.

Finally, arguments are sometimes advanced that U.S. dollars approved by the Congress for IMF purposes will add materially to U.S. Government borrowing requirements, thus further crowding out private borrowers in the credit markets. A somewhat related objection is that dollars allocated to the IMF are dollars taken from domestic programs. In our judgment, these arguments reflect a basic misunderstanding of U.S. involvement in IMF resource increases.

The U.S. dollars approved by Congress for IMF purposes do not constitute spending in the usual sense, nor do they add to the budget deficit. First, no money is actually paid to the IMF when the quota increase becomes effective. Instead, a non-interest bearing, non-negotiable Treasury note, payable on demand, is submitted to the IMF. Second, if the IMF draws on the note, it will credit the U.S. accounts with the IMF at the same moment. That is, the net asset position of the U.S. Treasury is unchanged. The U.S. government budget deficit is not affected as the U.S. Treasury gains an asset (the IMF reserve position) at the same time that it incurs a liability to the financial markets. From that moment on, the Treasury will have to pay interest on its outstanding obligations, but it will also earn interest on its IMF balances. Third, as economist Robert Heller of the Bank of America has described it, the net impact on U.S. credit markets depends on the way in which the country that borrows the funds from the IMF utilizes these funds. If the country uses the proceeds to acquire financial assets denominated in U.S. dollars or reduces its liabilities to U.S.

institutions, there will be no net effect on U.S. credit markets. If, however, the foreign country spends the IMF borrowings directly or indirectly on U.S. goods and services, there will be a net effect on credit markets, as the borrowing will not be counterbalanced by an inflow into U.S. credit markets. Credit markets will experience a net demand for funds, but at the same time U.S. exports will increase, providing a direct benefit to the U.S.

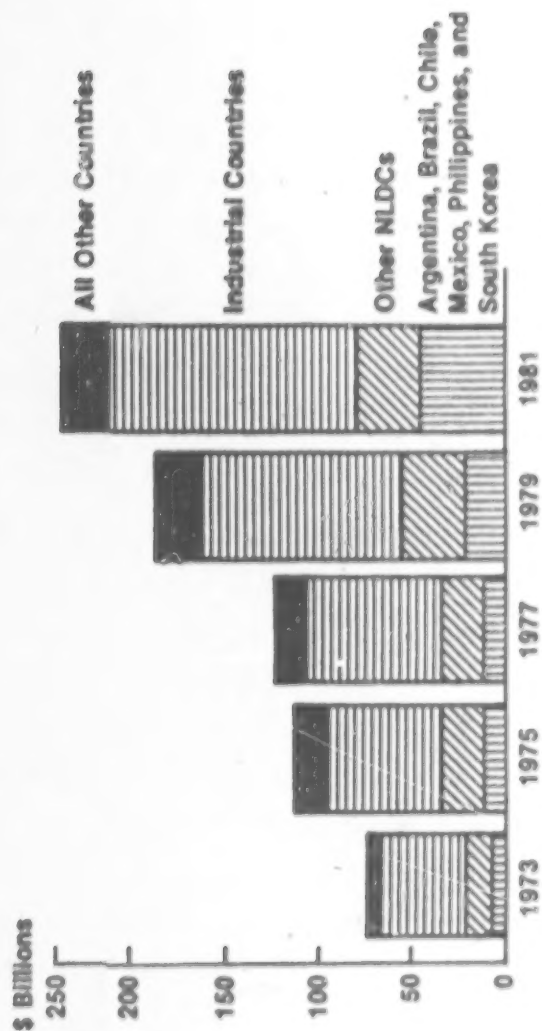
In sum, over the short term, IMF funding should have no effect on the U.S. budget deficit as the Treasury only posts a promissory note. Over the long term, IMF funding increases dollar spending by foreign countries, thereby supporting our own economic recovery.

CONCLUSION

For the reasons we have discussed in our statement today, we strongly support U.S. participation in increased funding for the IMF. The domestic and international financial markets are closely following U.S. action on IMF funding, and U.S. leadership and action on this issue will contribute greatly to market confidence in a continued and strengthened domestic and international economic recovery.

CHART A

DESTINATION OF U.S. EXPORTS



Source: IMF

CHART B

Value of U.S. Agricultural Production and Exports by State
FY 1981

STATE	Exports	Total Production (\$ Millions)	Exports as a percent of Production %
Alaska	N/A	13.8	0.0
Alabama	357.6	1989.1	18.0
Arizona	488.3	1722.3	28.4
Arkansas	1205.2	3239.0	37.2
California	3588.5	13551.8	26.5
Colorado	779.5	3057.0	25.5
Connecticut	24.6	340.2	7.2
Delaware	77.8	384.2	20.2
Florida	617.4	3366.5	18.3
Georgia	561.9	3067.6	18.3
Hawaii	58.6	459.5	12.8
Iowa	3737.2	10476.0	35.7
Idaho	634.3	2171.4	29.2
Illinois	3622.0	7636.7	47.4
Indiana	2011.8	4534.3	44.4
Kansas	2262.8	5721.8	39.5
Kentucky	606.7	2500.1	24.3
Louisiana	676.0	1731.9	39.0
Maine	29.3	478.9	6.1
Maryland	198.7	1034.6	19.2
Massachusetts	18.8	323.2	5.8
Michigan	943.6	2028.0	46.5
Minnesota	2344.1	6109.8	38.4
Mississippi	725.9	1992.2	36.4
Missouri	1318.6	4384.1	30.1
Montana	513.4	1680.8	30.5
Nebraska	2113.8	6102.4	34.6
Nevada	25.1	243.2	10.3
New Hampshire	3.5	97.1	3.6
New Jersey	61.0	476.9	12.8
New Mexico	151.1	1024.0	14.8
New York	261.1	2655.2	9.8
North Carolina	1219.7	4163.3	29.3
North Dakota	1143.7	2441.6	46.8
Ohio	1633.0	3774.1	43.3
Oklahoma	930.6	2872.0	32.4
Oregon	512.5	1651.4	31.0
Pennsylvania	267.8	2834.2	9.4
Rhode Island	0.8	33.9	2.4
South Carolina	332.2	1075.3	30.9
South Dakota	708.2	2727.8	26.0
Tennessee	435.8	1735.3	25.1
Texas	2576.7	10187.5	25.3
Utah	114.3	535.6	21.3
Vermont	7.1	397.0	1.8
Virginia	277.8	1506.9	18.4
Washington	1017.6	2777.1	36.6
West Virginia	23.4	226.1	10.3
Wisconsin	778.3	5198.7	15.0
Wyoming	93.7	683.5	13.7

Sources: Foreign Agricultural Trade of the United States, March/April 1982, Agricultural Outlook.

CHART C

Employment Related to Manufactured Exports by State 1977

State	Total (1000's)	Total as Percent of Civilian Employment
Alabama	45.3	3.3
Alaska	4.9	3.1
Arizona	29.1	3.3
Arkansas	24.4	2.9
California	329.1	3.6
Colorado	30.1	2.6
Connecticut	75.0	5.3
Delaware	10.0	4.0
Dist. of Columbia	1.7	.6
Florida	67.6	2.1
Georgia	65.7	3.2
Hawaii	2.7	.7
Idaho	10.0	2.8
Illinois	220.9	4.5
Indiana	113.1	5.0
Iowa	49.1	3.9
Kansas	30.1	2.9
Kentucky	44.9	3.3
Louisiana	34.2	2.4
Maine	12.1	2.9
Maryland	35.5	2.0
Massachusetts	105.2	4.3
Michigan	194.5	5.3
Minnesota	62.8	3.5
Mississippi	30.0	3.5
Missouri	65.3	3.2
Montana	4.6	1.5
Nebraska	15.7	2.3
Nevada	2.6	.9
New Hampshire	14.3	3.9
New Jersey	117.5	3.9
New Mexico	4.9	1.1
New York	233.6	3.3
North Carolina	93.1	4.0
North Dakota	5.7	2.2
Ohio	231.2	5.2
Oklahoma	30.4	2.7
Oregon	37.3	3.6
Pennsylvania	220.7	4.7
Rhode Island	16.0	4.1
South Carolina	54.6	4.4
South Dakota	6.6	2.3
Tennessee	61.6	3.5
Texas	164.8	3.0
Utah	11.5	2.3
Vermont	7.6	3.6
Virginia	56.1	2.6
Washington	61.1	4.1
West Virginia	22.9	3.7
Wisconsin	87.9	4.4
Wyoming	2.4	1.3
TOTAL	3,258.2	3.6

Source: 1977 Census of Manufactures.

CHART D

U.S. Domestic Exports of Selected Product Groups
to Six Countries in Latin America and the World, 1978-81 and 1981-82

Product Groups		Percentage Change 1981 - 1982		Average Annual Growth 1978 - 1981	
SITC Code	Product Description	Six Latin American Countries	World	Six Latin American Countries	World
79	Trans. Equip. except road motor vehicles	-50.25	-15.99	+39.82	+21.42
04	Cereals and cereal preparations	-43.71	-24.25	+29.22	+17.68
78	Road Motor Vehicles	-37.39	-14.72	+21.19	+5.35
74	Industrial Machinery and Equip. (mes)	-32.62	-14.52	+22.98	+15.33
71	Power Generating Mach. and Equip.	-23.21	+0.27	+24.17	+17.00
72	Machinery for Particular Industries	-21.59	-10.89	+24.00	+20.04
77	Electrical Machinery, Appliances & Parts	-17.93	-3.91	+22.51	+15.95

Notes. Data refer to aggregate for: Argentina, Brazil, Chile, Mexico, Peru and Venezuela. Average annual growth rates for 1978-81 are compound rates from natural log regressions of the form $\ln(x) = a + bt$, with 4 observations. Commodity groups are those totalling (for the six countries) more than \$1 billion at the 2-digit SITC level of disaggregation.

CHART E

DEBT OF NON-OIL DEVELOPING COUNTRIES BY TYPE OF LENDER

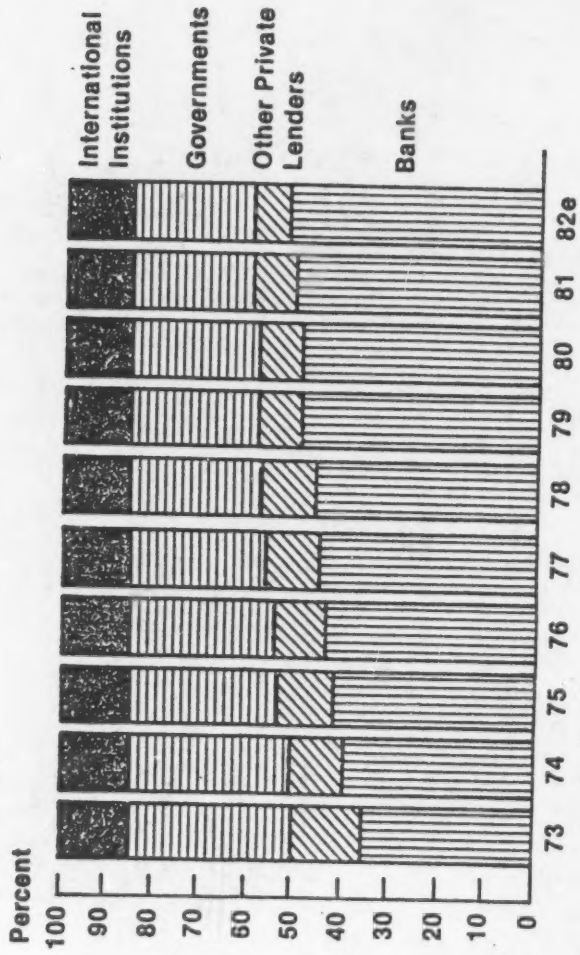
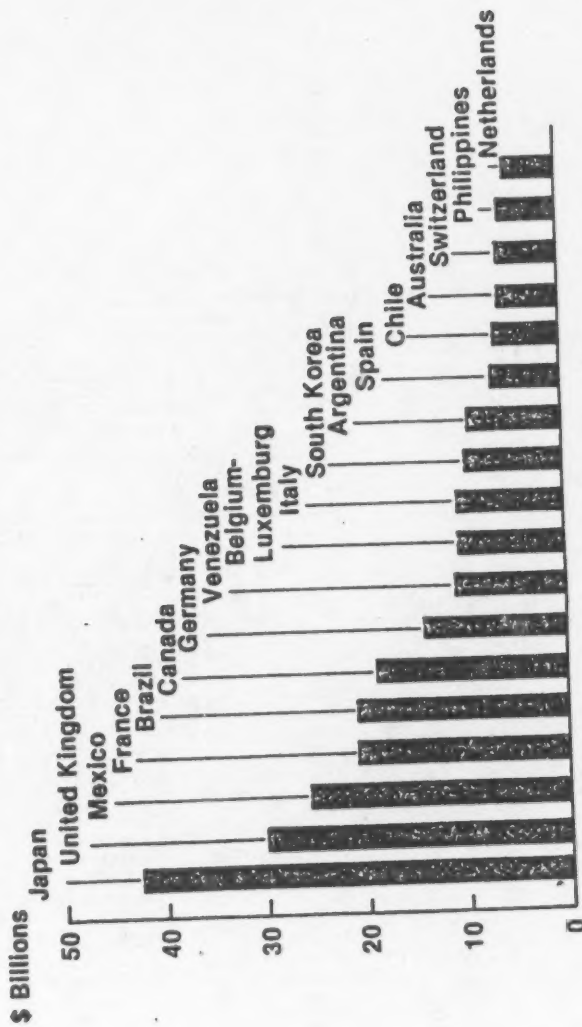


CHART F

U.S. BANK EXPOSURE TO INDIVIDUAL COUNTRIES*

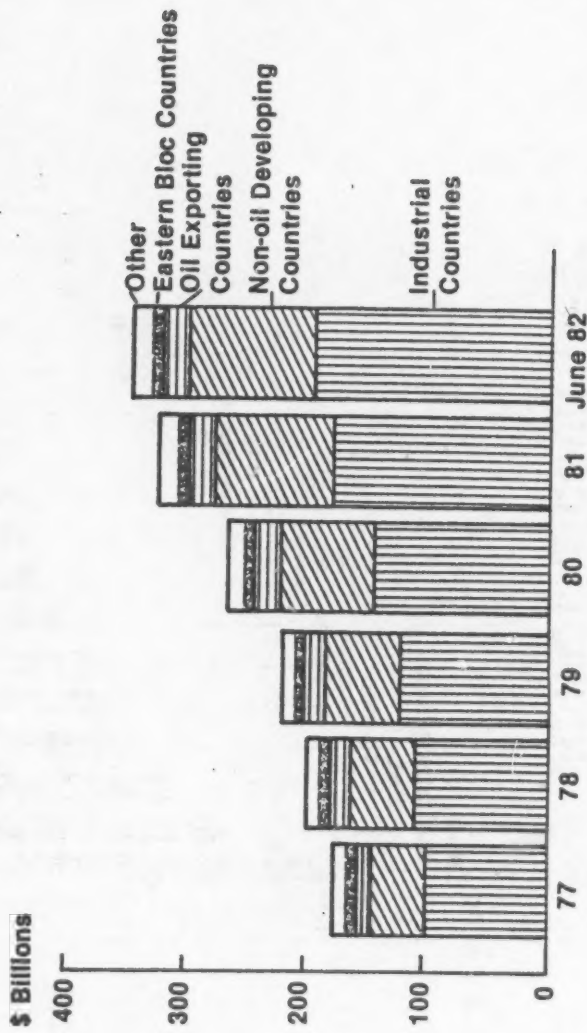


*Mid 1982, After Adjustments For Guarantees And Indirect Borrowings, But Excluding Commitments.

Source: FFIEC, "Country Exposure Lending Survey"

U.S. BANKS' INTERNATIONAL EXPOSURE

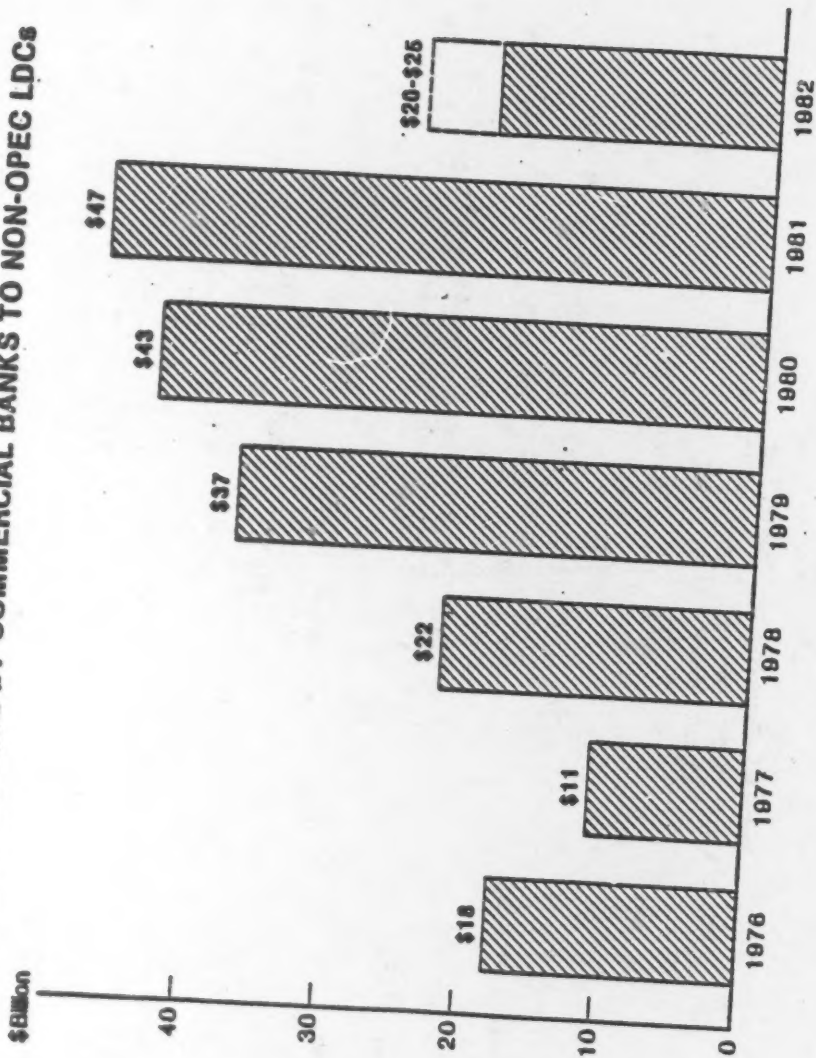
CHART G



"Other" Includes Offshore Banking Centers and International Organizations

Source: FFIEC, "Country Exposure Lending Survey"

CHART H
NET NEW LENDING BY COMMERCIAL BANKS TO NON-OPEC LDCs



U.S. Treasury Dept.
2-11-83

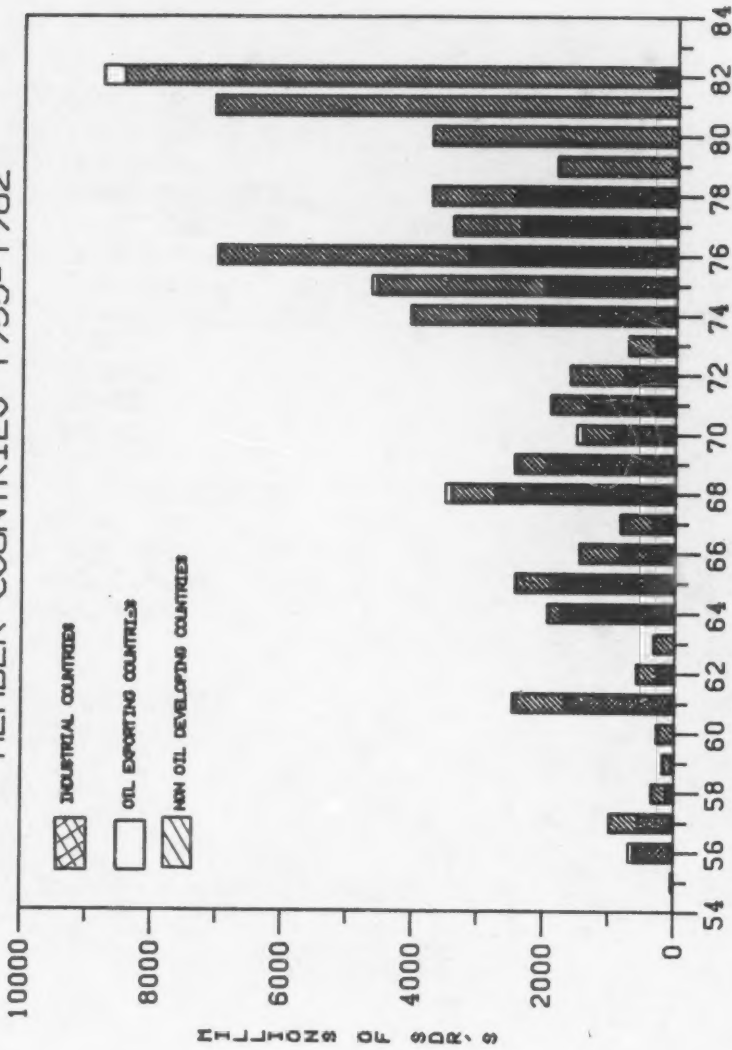
CHART I

Non-Oil Developing Countries:
Distribution of Debt by Class of Creditor
End of Year, 1973 - 1982

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Net Oil Importers										
Major exporters of manufactures										
To official creditors	27.9	26.8	25.6	26.3	25.6	23.7	23.1	23.2	21.6	21.0
To private financial institutions	53.8	57.9	59.5	60.8	62.2	61.3	64.5	64.2	66.5	68.3
To other private creditors	18.3	15.3	14.9	12.9	12.1	15.0	12.4	12.6	11.9	10.8
Low-income countries										
To official creditors	88.9	87.2	87.3	86.9	85.8	85.0	84.4	86.3	82.9	81.9
To private financial institutions	5.5	7.0	6.9	7.6	8.8	9.7	10.7	9.6	12.2	12.5
To other private creditors	5.6	5.8	5.8	5.5	5.4	5.3	4.9	4.1	5.0	5.6
Other net oil importers										
To official creditors	57.7	59.0	56.0	54.0	51.1	50.3	47.2	46.5	46.9	47.4
To private financial institutions	30.0	30.8	35.0	35.5	39.2	39.2	45.4	46.3	46.7	46.2
To other private creditors	12.2	10.1	9.1	10.5	9.7	10.5	7.4	7.3	6.3	6.5

Source: World Economic Outlook, IMF, 1982.

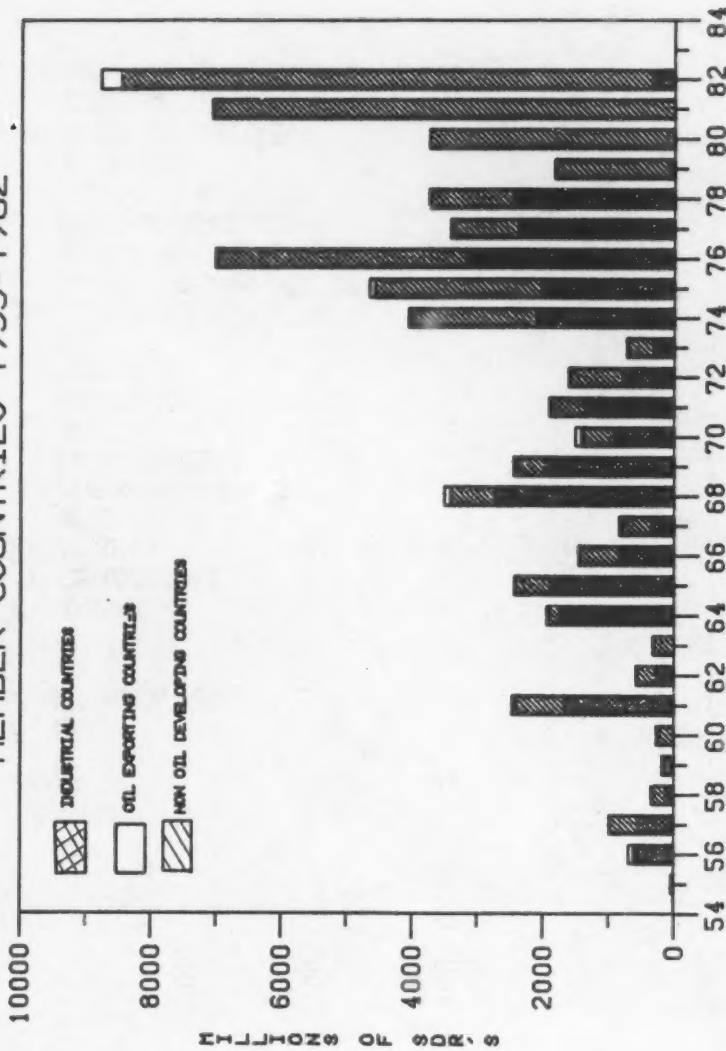
CHART J
ANNUAL BORROWINGS FROM THE FUND BY
MEMBER COUNTRIES 1955-1982



SOURCE: IMF, INTERNATIONAL FINANCIAL STATISTICS SUPPLEMENT ON FUND ACCOUNTS, SUPPLEMENT

SERIES NO. 3; IMF INTERNATIONAL FINANCIAL STATISTICS.

CHART J
ANNUAL BORROWINGS FROM THE FUND BY
MEMBER COUNTRIES 1955-1982



SOURCE: IMF, INTERNATIONAL FINANCIAL STATISTICS SUPPLEMENT ON FUND ACCOUNTS, SUPPLEMENT

SERIES NO. 3; IMF INTERNATIONAL FINANCIAL STATISTICS.

CHART K

IMF quotas as percent of world imports

<u>Year</u>	<u>Percent</u>
1981	3.7
1980	4.0
1975	4.2
1970	9.6
1965	9.1
1960	12.3
1955	9.8
1950	13.8

Source: International Financial Statistics, IMF; Direction of Trade Statistics, IMF; U.S Congress, House. International Monetary Fund Appropriations, 1981, H. Report 1263 to accompany H.J. Res. 601, 96th Congress, 2nd session.

CITIBANK

STATEMENT OF GEORGE J. CLARK, EXECUTIVE VICE PRESIDENT, CITIBANK

ACTIVITIES AT IMF

Senator KASTEN. Mr. Jack Clark from New York.

Mr. CLARK. Mr. Chairman, Phil Moon has made every point that I had in my statement and made them better than I would have. So I am not going to impose on the committee with my own statement.

There is one point I would like to make, however. I have been with the Citibank for 20 years, but before that I was 10 years in the International Monetary Fund. So I do have a little bit of a foot in both camps which gives me a little different perspective.

I did want to make one comment in one paragraph here from the talk I would have otherwise given.

Senator KASTEN. Was the recent article in the Wall Street Journal about life at the IMF correct?

Mr. CLARK. The executive directors? That was a very unfortunate article. Most of the executive directors are very, very competent, serious people. They selected very carefully the people they interviewed for that particular article. I was very sorry to see the Journal publish that.

It is a very competent organization and thank goodness it is there. If it weren't there, we would surely have to hurry and create it.

AUSTERITY PROGRAMS

The comment I wanted to make, though, relates to the so-called austerity programs of the Fund, and whether they are too austere. I noticed you were particularly interested in that when you questioned Mr. Roberts about Central America. I basically believe that the term austerity is very unfortunately used in this context.

I think it would be much better to call these programs making the best use of the limited resources available because I think that is really what the International Monetary Fund accomplishes.

After all, these programs are based upon the establishment of realistic exchange rates, the reduction of public sector deficits and excessive expansionary monetary policies as well as the establishment of positive domestic industry.

These are really nothing more than policies which all of us in this room would consider responsible policies and the availability of the IMF and the commercial bank financing in these programs is conditional upon performance. It never ceases to surprise me that these programs are so often criticized when they are basically efforts to encourage governments to abandon their own profligate financial policies.

When we talk about these programs we need to keep in mind that unfortunately member countries tend all too often to call in the IMF and to adopt the IMF programs only after their own programs have brought them to the edge of bankruptcy. So, what the Fund is normally dealing with is a situation which is already desperate and in which resources are already very limited.

Now, if fully implemented, these programs will bring about the adjustments on the balance of payments to insure the revolving nature of the IMF resources that Phil Moon commented on. Since they are conditional on performance and since they lead to reduction in deficits and are revolving, they should in no way be associated with any kind of aid-giving agency. These are hard programs, tough programs.

To associate them with aid-giving type programs or bail-out proposals is really not at all appropriate.

Thank you, Mr. Chairman.

[The prepared statement of George Clark follows:]

PREPARED STATEMENT OF GEORGE J. CLARK
EXECUTIVE VICE PRESIDENT, CITIBANK N.A.

Chairman Kasten and distinguished members of this Subcommittee, my name is George J. Clark and I am an Executive Vice President of Citibank, N.A. I appreciate the opportunity to discuss with you my views on the current international financial situation and the pending proposals to increase the resources of the International Monetary Fund.

Citibank supports the proposed increases because they are essential to the orderly adjustment process necessary if the world's economy is to recover with minimum difficulty and hardship.

My central point is that the global economy is now so interdependent that no country can isolate itself. Even the United States, which is less export sensitive than most other nations, still has 20% of its industrial output and 40% of its agricultural products exported, and one-third of all corporate profits come from foreign trade and investment. Countries can no longer spend their way out of a recession. They can only grow out of it together.

The IMF is crucial to this interdependent recovery process -- it is the central international monetary institution, established to promote a cooperative and stable monetary framework for world economic growth. It has a fine record. It is now doing a good job under difficult conditions. To continue to act effectively, it needs and deserves the full backing and support of the U.S. government, including the prompt approval of the funding requests now pending before this Subcommittee.

To further explain my conclusions, I will review the current international financial problems and then discuss the importance of the IMF in the global economic adjustment process.

The International Financial Situation.

The problem we're discussing, of course, is the external debt of the third world and East European countries. Today about 350 billion dollars are owed to about 800 private banks by borrowers situated in the 109 non-OPEC third world countries and Eastern Europe. This figure is in addition to an approximately equal amount which is owed by borrowers in such countries to governments, official agencies and suppliers. Virtually all of the 800 private banks are domiciled in the industrial countries of Europe, North America and Japan. About 150 banks hold three-quarters of this private external debt and Citibank alone holds about 5% of it.

Cross-border lending by private banks is not a new or even a recent phenomenon. It has been going on for centuries. It finances world trade, both imports and exports. It finances long-range development projects. It finances temporary trade imbalances. When bankers perform this international intermediary function of channeling excess funds from savers and investors to constructive users of funds, they are a powerful force for economic growth.

The only really new phenomenon is the rate at which such private cross-border lending grew in the last 10 years.

Commercial banks were a powerful factor in the expansion in third world lending in the last decade. That growth was caused in large part by events over which the banks had no control, namely, the oil shocks of 1973-74 and 1979-80, which transferred huge amounts of funds from the third world and industrialized nations to the OPEC nations. 200 billion dollars was transferred as a result of the first shock, 200 billion dollars more as a result of the second. Much of these funds found their way from the OPEC oil exporters back into the world's commercial banking system, and the system channeled it to the world's creditworthy users of capital. In short, the system did exactly what it was supposed to do.

The countries to which the funds were rechanneled had good investment opportunities and generally used the funds well. They were able to increase output rapidly, expanding their own economies and thus local markets for producers in other countries. At the same time, they increased their own exports to service their higher level of debt. The economies of the oil importing developing countries grew faster than in any comparable prior period and also faster than those of the industrialized countries. The best performance was in precisely those countries, such as Brazil, Mexico, and Korea, which received the heaviest infusions of capital.

For seven years, from the end of 1973 to the end of 1980, the export earnings of the 109 non-oil developing nations grew at a compound annual rate of 20.6%. And that just about matched the 21.3% annual growth rate of their long term external debt. These figures rather compellingly refute the proposition that the banks made imprudent or non-productive loans to the LDC's.

While the non-oil developing nations, by intelligent and proper use of external debt, were successfully coping with the problem of adjusting to the oil shocks that had raised oil prices to 1500% of their pre-1973 levels, a new and less publicized adjustment began to develop around 1979. The industrialized countries began to systematically attack the problem of inflation through stringent monetary policies. As a result, interest rates, and subsequently unemployment rates, rose to unprecedented postwar levels. The eventual doubling of interest rates not only slowed the economic growth of the industrial countries but also greatly increased the debt service burden of the non-OPEC developing countries. And this happened just at the time that the prices of such commodities as copper, coffee, cocoa, sugar and the like dropped by more than one-third.

Simply stated, the third world countries' dollar outflows increased just as their dollar inflows decreased. This brought about the next -- and current -- phase, a liquidity crisis.

Before discussing the role of the IMF, let me return to my basic point about global economic interdependence, and stress what the past decade's developments in the LDC's have meant for us right here in the U.S. As I suggested earlier, the export sector of our economy has been the leader in recent years in creating new jobs. Many of these new jobs were created with respect to exports to the non-OPEC LDC's -- the very debtor nations the IMF is most concerned about. The recent economic set-backs in those countries have produced a clear and decidedly negative effect on U.S. jobs because they have been forced to cut back on buying our products and services. In other words, LDC economic activity is a matter of concern to all American workers -- farming, manufacturing, and service sector, too -- not just to a handful of large banks. For further general discussion of these points, I commend to your attention Secretary Regan's Senate Banking Committee Statement (April 7, 1983 at p. 4-7).

Let me tangibly illustrate what all of this bank lending meant to our domestic economy by giving as examples just two Citibank LDC loans. First, Citibank participated in the financing of four A-300 aircraft costing approximately \$40 million each for Varig-Cruzeiro Airlines of Brazil. While these aircraft were manufactured by a European consortium, the engines -- representing approximately 18% or \$29 million of the total equipment cost -- were manufactured by General Electric near Cincinnati, Ohio. This transaction illustrates just how highly interrelated and economically interdependent our world has become -- a Brazilian airline buys European airplanes and creates jobs in Ohio, with the help of Citibank. Another example is Mexicana Airlines of Mexico. Citibank was lead bank for a syndicated financing of three Boeing 727-200 aircraft with an approximate total cost of \$48 million. These aircraft were manufactured in Seattle and the engines representing 20%, or \$9 million, were built in Middletown, Connecticut by Pratt and Whitney, a subsidiary of United Technologies.

Compare this last example with a recent headline in the New York Times, (2/5/83 at p. 33) announcing that Pratt and Whitney was then laying off 2300 workers in Connecticut because of falling domestic and foreign demand. Those who criticize Citibank's loans to Mexico and Brazil might wish to compare notes with the unemployed workers in Seattle, Cincinnati and Middletown.

The IMF and the Current Adjustment Process

The world now faces a difficult but manageable liquidity problem. For the reasons mentioned, certain third world and Eastern European nations are temporarily unable to earn enough foreign exchange to pay currently maturing debt.

Solving these liquidity problems will require debtor nations to make "adjustments" so that, over time, they can meet their obligations. This adjustment process is already ongoing in nearly every one of the nations in question. While the results so far are promising, much remains to be done and it would be premature now to predict ultimately successful solutions and strong global economic recovery.

The world can choose between at least two sorts of "adjustments" -- the 1930's version where every nation goes it alone, or through international cooperation whereby debtors, creditors and all concerned nations work together to ameliorate common problems and work out the most orderly adjustments.

It is inconceivable to me that any reasonable person would choose to return to the economic barbarism of the Great Depression for the model to solve today's problems.

In fact, of course, nearly two generations ago the U.S. and the other nations of the world rejected that approach and deliberately set up such procedures and vehicles as GATT and the IMF to find a better way to solve the world's international economic problems. In part because of agencies like the IMF, the post-war world has seen unparalleled global economic growth and prosperity.

The IMF plays many parts, but of particular importance for today's discussion are its role in providing short term financing to countries with liquidity problems and in working out the quid pro quo "conditionality" designed to assure that an orderly adjustment does, in fact, take place whereby a nation's underlying economic problems are solved, restoring it to a position where it can service both its IMF and other indebtedness and attract needed private capital.

The two -- short term loans and conditionality -- go hand in hand. The conditionality can be said to be more important insofar as it is the key to the real solution of an orderly adjustment. But the short term loans are usually indispensable, both to help meet a nation's foreign exchange needs and, also, as part of the domestic political process required to get acceptance of the "conditionality". You can't have one without the other as a matter of practicality; there must be both carrots and sticks.

Crucial at this point in the analysis is the concept that the IMF is an indispensable catalyst for the necessary adjustments to take place. While, theoretically, the debtor nation might be able unilaterally to adopt the necessary adjustments, and private lenders might be willing to work with debtor nations one-on-one while these unilateral reforms are taking place, this too often is just not how it works in the real world. Internal political pressures generally make it impossible for a government to put its own house in order. A catalytic neutral third party -- the IMF -- equipped with carrots as well as sticks, is generally needed to offset these internal political pressures. Similarly, the IMF's approval of an adjustment package is often the "seal of approval" necessary to convince private lenders that they should continue to be patient and forbearing.

Thus, we come down almost to a syllogistic proposition:

- o The IMF needs adequate resources to perform its indispensable functions in facilitating an orderly global economic adjustment;
- o The world economy needs the IMF to be fully able to perform these functions;
- o Therefore, all nations, both developed and developing, should want the IMF to have adequate resources.

Concurrence here, of course, does not dispose of all relevant questions with respect to the appropriation request now pending before this Subcommittee. Two that quickly come to mind involve possible alternative sources of funding and the optimum level of funding. With respect to the first, suffice it to say quota increases are the method preferred by the relevant nations of the world, and endorsed by our Administration. The moment has passed to consider competing alternatives; rejection of the pending proposal would, in the short term at least, be considered by the world as rejection of the funding increase *per se*. This could do great harm to the IMF, specifically, and to U.S. credibility, generally, at a time when such risks can be ill afforded.

With respect to the appropriate level of funding, it is our judgement that the requested amount is reasonable and appropriate considering such factors as expansion of world trade since the last quota increase (approval of this request barely keeps the IMF current in terms of the real value of the overall U.S. contribution) and the enormously important challenges facing the IMF over the near and medium term. For a more detailed analysis of this point, see Regan, *op. cit. supra* at p. 10 *et seq.*

Of course, if the increase is not approved, everyone concerned will simply have to adjust to that decision: the IMF would be forced to adjust; the banks can and will adjust to it; and, particularly, the developing countries, will have to adjust to it. The distinguished members of this Subcommittee and their constituents will also have to adjust to such a decision - in lower demand abroad for U.S. exports, thus reducing job creation in your districts' manufacturing, farming and service sectors where unemployment would remain at higher than necessary levels. The IMF quota increase proposal will materially affect domestic jobs because, as discussed above, a growing number of our workers and farmers depend on healthy foreign markets for their livelihood. IMF intervention, and conditionality, may not always mean a debtor nation can maintain its previous levels of imports from the U.S. or elsewhere, but it generally does mean the least possible disruption in such imports because the resulting adjustment is more orderly than would otherwise be the case. *Id.* at 14 *et seq.*

Conclusion

For all of the foregoing reasons, it is respectfully suggested that the Subcommittee act promptly and favorably on the pending request to increase IMF resources.

IMF POLICIES ON FOREIGN ENTREPRENEURSHIP

Senator KASTEN. Mr. Clark, a lot of people don't complain about the restrictions on Government, but there is an effect of some of the IMF policies to increase taxes on entrepreneurship and on the workers, the effect of which is to limit the opportunities for capital investment and reinvestment.

If we are going to have the kind of economic recovery we are hoping for in a number of these countries, we look to models like Taiwan or Korea. We have seen capitalism and entrepreneurship at work, and to come in and essentially impose a Keynesian kind of model on these different countries, increase taxes, reduce the opportunities for entrepreneurship, seems to many people to be going in an absolutely opposite direction.

Ideally what you want to do is to have the best place in the whole world to invest your money and have return on resources. In some cases that is the opposite direction that the IMF is going in.

Mr. CLARK. I like your selection of the models. Korea and Taiwan are good models. What is not often understood really is that the Fund programs are trying always to search out for equilibrium in the balance of payments, equilibrium in the exchange rates, equilibrium in the finances of the government, precisely because the free market can operate.

I know it is not normally presented this way, but the basic program of the Fund is to try to reach equilibrium so that the role of government can be reduced. It is very much a free market model that they work from.

Take, for example, the recent case of Mexico. Under the last year of the Lopez Portillo administration you had a 16-percent budget deficit. That created a lot of inflation, it created capital flight, it resulted in an overvalued exchange rate.

The efforts of the Fund are to get the Government sector reduced and brought into equilibrium so that the free market can operate. It is true that if you have a big fiscal deficit, and that is the source of the problem, you have to deal with it.

Hopefully you deal with it on the expenditure side. You know, if you are left thereafter with a live fiscal deficit just as here in the United States, the overriding objective becomes reducing that deficit and sometimes that does call for increased taxes.

Senator KASTEN. Right this minute on the sixth floor the Budget Committee is meeting and I should be sitting right there as well. We understand the problems of deficits.

I am thinking more of an example. One example would be Honduras. We go in, we increase the taxes on working and on investing and on saving. The effect is to discourage capital from going into Honduras.

At least we don't have the same kind of reward for success as we had before the IMF came in with its program.

Mr. CLARK. The IMF will address the problem in the following way. They will say to the Government there is a certain fiscal deficit and it has to be reduced. It does have to be reduced because you have inflation.

Now, they leave it to the Government. The Monetary Fund does not step in and say pass a regressive tax system. That is really left up to the Government to cross the gap.

What the Fund is after is the reduction in the deficit. It is up to the Government really to best determine how it can do it within its own political reality. The formula does vary from country to country.

EXCLUSION OF SOCIALIST COUNTRIES FROM IMF PROGRAMS

Senator KASTEN. Mr. Pierce, if we could go back through your testimony, and substitute Eximbank where you say "IMF," your testimony would have been almost the same as the testimony that you and others have given previously.

How would you respond to the same question I asked Craig Roberts earlier: Why are we in this thing in terms of a multilateral financial institution when significant proportions of the IMF moneys are going to Socialist countries and others that don't share our basic principles of democracy?

Wouldn't we be better off working in a bilateral way and couldn't we do this job better and do more for export jobs, if we were working directly with countries?

Mr. PIERCE. Experience and looking at the nature of the foreign competition that we have abroad, namely a multinationalized enterprise that is made up of three or four countries, I would not want to put the ability of the U.S. Government on a bilateral basis to compete with multinational organizations that use that power. I am not sure in the case of bilateral we would come out on an even basis.

As to the issue of the IMF, not all of these are IMF investment programs, Chile, Peru, Mozambique, Brazil, Malawi. These are real time marketing programs that we have going on at the present time.

In certain cases because of the IMF adjustment programs we see the host countries have gone to slowdown on their imports, even though the aircraft may be extremely productive, especially some of the new aircraft types.

However, when we look at the alternative, what is our choice? If there was simply a free and open market, one where there was simply no kind of multilateral international discipline as a financial bargaining place such as the role that IMF performs, I would be concerned indeed because some of those countries internally politically cannot pull their programs together, if I can speak candidly, simply because the body politic may not tolerate that whereas the IMF has the external force and a lot of times I think the IMF takes the heat for it, can bring together a program, an adjustment program, in that host country on a multilateral basis which makes it possible for the political leaders to cope with in development programs.

Otherwise we are going to have a great deal of political economic instability in many of the countries. We have seen it in Sao Paulo recently.

I am not sure that answers your question.

The Exim, I might add, faces the problem that in certain cases there is simply not the ability of the country to take on additional debt. There may be ample funding, but the Minister of Finance says, "No more debt, we cannot take any more debt."

We are trying to work out some alternate program which would assist in getting around some of these problems where we see a productive aircraft going into the system and servicing the needs of the host country, but keeping a sound balance sheet.

However, the assumption has to be that the aircraft itself is so productive that it will not only pay its own way, but enhance the total airlines system, which it will, because of the direct operating cost savings, fuel-burning savings are as high as 40 or 55 percent.

Some of those developing countries where they are operating aircraft of the first generation suffer severe fuel cost. Somehow we have to work on a shared risk basis to try to get around this problem.

On a bilateral basis I am not sure. I would be hesitant. I have seen how our foreign competitors work on a routine basis using the consortium.

AUTHORIZATION LEGISLATION RESTRICTIONS

Senator KASTEN. Just for the purposes of the record, I would like to get each of the bankers to respond to a couple of the restrictions on foreign lending included in the recent IMF authorizing legislation.

We are an appropriating committee, not an authorizing committee, but we will be picking up or deleting or amending some of the restrictions that have already been included. Generally speaking there are four of them.

The first is the close scrutiny of foreign loans;

The second is the requirement to maintain special reserves;

The third is greater public disclosure by banks; and

The fourth is the requirement to stretch out rescheduling fees.

Let us begin with No. 1. I will ask Mr. Moon and then Mr. Clark to respond.

What is your view of the restrictions on foreign lending in the IMF legislation having to do with the closer scrutiny of foreign loans?

Mr. Moon?

Mr. MOON. I think most of the banks, and I think BAFT's position in general, is that we do not object to more reporting, more information on foreign lending.

The proposal that the banks' exposure to foreign loans be increased to a quarterly report is entirely proper, and I don't think is one that any of the banks are resisting.

Mr. CLARK. I agree entirely with Mr. Moon, Mr. Chairman.

BANK MAINTENANCE OF SPECIAL RESERVES FOR LOANS TO INDEBTED COUNTRIES

Senator KASTEN. What is your opinion of the requirement for banks to maintain special reserves for loans to countries with protracted debt problems?

Mr. MOON. I think our view of that is that it does create very great dangers. Anytime you start requiring banks legally to main-

tain reserves against specific classes of assets, in this case international loans, the question may come, are you going to require specific reserves against energy loans which also have been in trouble at times or against other specific types of loans, real estate a while back?

In addition to which the danger of requiring specific reserves is that the smaller regional banks are going to be reluctant, their Boards are going to be reluctant to let them get into international banking if they can see there is a possibility down the line that it may affect their earnings not based on whether or not the loans ultimately are good, but simply on whether or not they have to set aside specific reserves out of earnings which will affect their profit and loss statement.

Senator KASTEN. Mr. Clark.

Mr. CLARK. Mr. Chairman, this is a very serious consideration. As Mr. Moon indicates, there is a possibility of real risk here. Some reserves for some particular cases are appropriate and some banks are already taking them. So it is not a no-no, but it is a very tricky subject and needs to be handled carefully.

I think the threat lies in the possibility that the legislature may vote in this case something that is really quite tough and the way the House Banking Committee bill came out, for example, I would classify it as quite tough.

If you make it so tough, you really drive the banks not only to not bank new loans, but to start collecting on the old loans.

Now, there is \$400 billion of debt outstanding here. If the banks are motivated to go out and collect that debt under today's conditions, I think the threat would be similar to what happened here in the 1930's in the United States when the Federal Reserve reduced the U.S. monetary base by 30 percent from 1929 to 1933 and I think that is what brought on the domestic depression.

The threat here would be that the banks would contract globally the way the Fed did domestically and produce an even worse global scenario than we have today. That is the risk. If you get into this business, it is very important how you do it.

The House Banking Committee bill associates setting up of the reserve with rescheduling. That is the criterion they have used. Rescheduling today is the name of the game.

I think the most productive and useful thing the banks can do today, and Paul Craig Roberts mentioned this in response to one of your questions, is that we reschedule the debt and we ought to be encouraged to do it and if the legislation is not handled properly, we will be driven to do exactly the reverse.

PUBLIC EXPOSURE OF BANKS LENDING TO INDIVIDUAL COUNTRIES

Senator KASTEN. Another one of the points some of the authorizers raised is greater public exposure of banks when they concentrate their loans to individual countries.

In a discussion of that it is my understanding that there was some thought at least of country-by-country quotas or country-by-country allocations or whatever.

Mr. Moon, could you comment on greater public disclosure by banks when they concentrate their loans on individual countries?

Mr. MOON. I think I tried to answer that before. I do not believe any of the banks really object to more disclosure on where our loans are being made. We would object I think to being told, to have country limits set legislatively.

We think there is a great deal of danger in that. We all set our own country limits internally in the banks. Even the comptroller's office examining national banks asks us what our country limits are.

I think we will all continue to do that. Just as Jack said, we all set aside reserves against our loans because we feel it is necessary for their collection.

I think we would find great difficulty with having external forces set country limits artificially.

Mr. CLARK. I concur, Mr. Chairman.

Senator KASTEN. The last general point that has been covered in some of the authorizing legislation has to do with the requirement to stretch out over the life of the loan the rescheduling fees.

My understanding is that a number of these loans have been coming in between 1 and 2 percent over the going rate and that premium has been going directly into bank profits.

First of all, is that correct, and second, how do you react to the requirement that we stretch out the scheduling fees over the life of the loan?

Mr. MOON. The higher interest rate would only be taken in as the life of the loan has gone along. They are not taken up front. As to the rescheduling fees, Jack can answer because his bank is larger. We are not large enough and are not collecting those fees.

RESCHEDULING FEES

Senator KASTEN. I understand there is a difference between rescheduling fees and an interest rate that is higher because theoretically the loan is riskier, therefore the reward should be greater.

Obviously, if the IMF is going to guarantee the loan, it is not a particularly risky loan, and maybe it should be at a lower rate of interest. That is another kind of discussion.

Now, some of the authorizers are requiring that rescheduling fees be stretched or at least it be spread or amortized.

Mr. CLARK. I think we are basically talking about the same thing. We agree with the concept that the fees should be stretched out over the life of the commitment, if it is a commitment fee or the loan if it is a loan. We have no problem with that so far as Citibank goes.

You mentioned IMF guaranteeing the loans. I would not want the comment to pass. We are not thinking in terms of the IMF guaranteeing any loans. Did I misunderstand?

Senator KASTEN. You are right. My choice of words was not correct.

The loans are certainly less risky with the IMF there than they are without the IMF. That is the opinion of many, at least.

Mr. MOON. Hopefully if the IMF is there, they will help the countries to remain economically sound through their various measures, and anything which keeps the world economy sound obvious-

ly makes our loans anywhere in the world safe, even including our domestic loans.

Mr. CLARK. We do a lot of lending to governments where there is no IMF program, but we are doing it because they are following good programs of their own.

Brazil did not negotiate with the IMF until recently, but we were lending to them because they were following a good policy.

Senator KASTEN. Mr. Clark, it has been widely reported that Mr. Theobald of your institution replied in reference to the Polish debt situation that, "We don't care; we don't know which system of government works best. All we care about is can a country pay its debt?"

Is this a standard view in your institution and among bankers in general?

Mr. CLARK. Are there any lawyers in the room? Mr. Moon, you speak very nicely for industry, would you care to comment?

Mr. MOON. I can hardly comment on Mr. Theobald's point of view.

Mr. CLARK. I feel the same way. Will you excuse me, Mr. Chairman?

Senator KASTEN. It goes back to the question that I asked Jack Pierce earlier. There is a concern when we are talking about the sums of money, and 20 or 21 percent of IMF is our dollars, as to where those dollars are going.

A number of those dollars are going to Socialist countries, Communist countries, to countries that do not share our goals in terms of democracy. Perhaps Mr. Theobald wishes he had not said that or at least it had not been printed as widely as it was.

That was in regard to the Polish debt situation. About 84 U.S. Senators were on our side in terms of trying to not use the Commodity Credit Corporation dollars to pay interest and principal on the Polish debt or at least to have it in fact go into default before we used the CCC dollars, but that is neither here nor there.

Why should we be contributing money to a multilateral institution like the IMF that doesn't consistently share our goals?

Mr. CLARK. That is quite a philosophical question. The IMF does address itself to balance-of-payments efforts. It was set up to do that. It is enormously good at it. The question comes whether you then try to build in some other criteria. You know the apartheid thing came up recently. You have to sort of decide, when you have an agency that is doing a splendid job at one particular thing, whether you start to try to get it to do other things.

You know, this is something that good people might disagree on, but my own statement would be the IMF works on balance of payments; we need that; it is terribly important for many of the reasons that Phil Moon commented on.

Let us just be thankful they are there, and they are doing their job as it was set up to do, and let us not try to bring in a lot of other elements to that.

Mr. MOON. Mr. Chairman, I would like to add one thing. We are not, of course, providing all the money that goes into IMF. I think you said about 20 percent. Therefore, we hardly can be in a position of determining that it will only go to our friends. If we do that, then the other 80 percent, somebody else will say, can only go to

their friends. It is a fact if you use a multilateral organization such as this, your money is leveraged.

In other words, it joins other funds in providing help for the world economy.

BAILOUT OF FAILING BANKS

Senator KASTEN. Mr. Moon, there is a strong feeling by a number of organized taxpayer groups that the IMF, by the replenishment or the additional contribution, is essentially enabling the stockholders of banks, large lending institutions, to escape from losses due to shaky loans, the idea being that if it were not for the increase, and this was suggested in the context that we need the export markets—yesterday when I made this point to the Secretary of the Treasury, he was claiming that the banks would be back to these countries with even more loans and in effect there was no real bailout, that the banks were still exposed.

In a way that kind of begs the question. Isn't it a fact that if the shaky loans are in effect saved by IMF intervention, we are in effect bailing out the banks?

This is a concern that many people have had, especially because these loans have been profitable loans, they have been at 1 point or 1½ points, maybe 2 points, over the standard lending rates, those dollars go into profits. The loans were shaky loans, but yet the stockholders, the officers and the others suffer no penalty personally or corporately for the lack of prudence and discipline over the past few years.

Is this fair?

Mr. MOON. It is a complicated question, but it would seem to me that to begin with the banks have loans which they are already recognizing as uncollectible, taking special reserve, some of us are classifying these loans as nonperforming which means we are no longer accruing interest. We are taking money out of our earnings and putting them in loss reserves for those loans.

The ones we are not treating is because we feel the countries are sufficiently strong so that if the economy continues to grow and expand, the countries will be able to repay the debt in a normal period of time, the higher rates are prospective for the future.

The outstanding loans were made in many instances at very low rates, very small margins. The extending of the loans or the restructuring of the loans which is being done today is being done at higher rates in many cases because of the fact that there are more increased risks evident now than there were before.

Obviously, the return should be somewhat higher. I don't see that the IMF, as we have already pointed out, is requiring the banks to put more money in and it is all in an attempt to keep the world economies going, the LDC economies in particular, to the point where they can repay their debts on their own out of their normal export business.

Mr. CLARK. Mr. Chairman, could I make one comment because I know this issue of the return is very much on people's minds.

I would like the record to show that in spite of the fact that the interest rates have increased and, as you said, reflect the increased risk, we have a terrible time putting these packages together. We

started on the Mexican package on November 16 and we completed it on March 16.

You know, if the impression is that the banks are making a lot of money and therefore are very pleased with all of this, that is really not the case. We need the extra income because we are writing off the additional reserves and because it is very difficult to keep the banks participating in this activity.

Mr. MOON. I would agree with that completely.

COMMERCIAL BANK LENDING TO FOREIGN COUNTRIES

Senator KASTEN. I am told that George Champion, former chairman of the Chase Manhattan, recently stated that many bankers believe that lending to foreign governments is not really the function or ought not be the function of commercial banks.

I assume he is suggesting, I don't have the whole quote here, that it ought to be the function of governments or of multinational financial institutions.

What does he mean here and what is your view? Ought commercial banks be lending to foreign governments?

Mr. CLARK. For decades Mr. Champion has been saying, Mr. Chairman, that we should not lend to governments because if governments ever decide to not pay us, there is not really much we can do about it. There is not a court of law we can take them to because they are a government and we are a commercial bank.

So, people have that point of view. We always felt that while it is true from a legal point of view that a bank cannot take a government into a bankruptcy court, the governments have the same interest in servicing their debt that any other borrower has.

The government has just as much interest in maintaining their credit standing, particularly because they need new money. That is particularly true of the developing world where they have to import capital because they are so short of capital themselves.

So, we don't really think that the legal point that Mr. Champion attaches his argument to really works out that way in practice.

Mr. MOON. Mr. Chairman, you might realize, and probably do, that the Louisiana Purchase by the U.S. Government was financed by Dutch banks and commercial banks had been lending to governments at least for that long period of time, and I think back during the war years the Rothschilds financed many of the governments of Europe.

Senator KASTEN. I would like to thank you.

This concludes our hearings for the 1984 supplemental request for the IMF.

I would like to thank the three of you. I know you all came a long way. The issue is a difficult one. Your testimony here has been extremely helpful. The fact that we had a balanced view is greatly appreciated.

I also appreciate the fact that the Chamber is going to be working with the administration in trying to get this through. As I think all of you are aware, it is not included in the supplemental appropriations bill of the House.

If we go forward here, it is going to present some hurdles that we are going to have to overcome in a conference with the House and

there are a lot of uncertainties as to the direction we are going in. The help of the three of you today is greatly appreciated.

CONCLUSION OF HEARINGS

This concludes our hearing. The subcommittee will stand in recess, subject to the call of the Chair.

Thank you.

[Whereupon, at 10:50 a.m., Wednesday, May 18, the hearing was concluded, and the subcommittee was recessed to reconvene subject to the call of the Chair.]

